90-984

No. —

In The

Supreme Court of the United States

October Term, 1990

Kansas Gas and Electric Company,
Petitioner,
v.

State Corporation Commission
of the State of Kansas, et al,
Respondent.

Petition for a Writ of Certiorari to the Court of Appeals of the State of Kansas

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PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Under the Federal Power Act, the Federal Energy Regulatory Commission (FERC) has exclusive jurisdiction to regulate wholesale electric rates and to set the terms and conditions of wholesale interstate electric transactions. This case presents a question involving the power of state regulatory commissions to nullify FERC's regulation and otherwise to burden the sale of wholesale electric power across state lines:

> Whether the Federal Power Act permits a state regulatory commission, in setting intrastate retail rates of a seller of wholesale power, to reject the interstate wholesale rates established by FERC and to impute a wholesale rate that is greater than the FERC-filed rate?

PARTIES BELOW

Kansas Gas and Electric Company was an appellant in the Kansas Court of Appeals. Beech Aircraft Corporation, The Coleman Company, Inc., LaFarge Corporation, Total Petroleum, Inc., and Texaco, Inc., were also appellants in the Kansas Court of Appeals on issues unrelated to those raised in this Petition.

The appellee was the State Corporation Commission of the State of Kansas.

The Citizens' Utility Ratepayers Board intervened in the case below before the Kansas Court of Appeals.

RULE 29.1 STATEMENT

Kansas Gas and Electric Company owns an 80 percent interest in CIC Systems, Inc., and a 47 percent interest in both the Wolf Creek Nuclear Operating Corporation and in the Utility Fuels Company. Kansas Gas and Electric Company currently has no parent company. Kansas Gas and Electric Company and Kansas Power and Light Company signed an agreement on October 28, 1990 to merge those two companies. Under the agreement, which has been approved by the boards of directors of both companies but has not yet received shareholder or regulatory approval, Kansas Gas and Electric Company would become a wholly-owned subsidiary of Kansas Power and Light Company.

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IN THE

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OCTOBER TERM, 1990

No. ———

KANSAS GAS AND ELECTRIC COMPANY,
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STATE CORPORATION COMMISSION
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PETITION FOR A WRIT OF CERTIORARI

Petitioner Kansas Gas and Electric Company (KG&E) respectfully prays that a writ of certiorari issue to review the judgment and opinion of the Kansas Court of Appeals entered in Case No. 90-64976-A on June 29, 1990.

OPINIONS BELOW

The opinion of the Kansas Court of Appeals (Appendix 1a) is not reported. The February 13, 1990 Order of the State Corporation Commission of the State of Kansas (KCC) in Docket No. 142,098-U, 84-KG&E-197-R (Appendix 25a) is not reported.

JURISDICTION

On September 20, 1990, the Kansas Supreme Court denied KG&E's Petition for Review of the June 29, 1990

opinion of the Kansas Court of Appeals (Appendix 24a). This court has jurisdiction under 28 U.S.C. § 1257(a).[1]

CONSTITUTIONAL AND STATUTORY PROVISIONS

The United States Constitution, Article VI, Clause 2: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land. . . ."

The pertinent provisions of the Federal Power Act, 16 U.S.C. §§ 824-824e, are reprinted at Appendix 183a.

STATEMENT OF THE CASE

Introduction

This case stems from the ongoing tension between FERC's exclusive authority over interstate wholesale power transactions and the local sphere of interest of state utility regulators. Nationwide, wholesale electric power is produced from many sources and then transmitted across state borders to local electric utilities for resale. These power sources produce electricity at widely varying costs, leading to disputes between states or between state and federal regulators over the appropriate

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[1] The Kansas Court of Appeals held that the KCC in setting KG&E's retail rates had authority to assume that KG&E had collected a higher level of revenues on an interstate power sale than was permissible under the FERC-filed rate. The court of appeals rejected KG&E's arguments that the KCC's orders imputing revenues above the FERC rate were contrary to federal law and the Supremacy Clause because they intruded on an area preempted exclusively to FERC's jurisdiction. Orders by state utility regulators have long been viewed as "state statutes" within the meaning of 28 U.S.C. § 1257. *Lake Erie & Western Ry. Co. v. State Pub. Utils. Comm'n*, 249 U.S. 422, 424 (1919). *See generally Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986). The recent amendments to 28 U.S.C. § 1257 that narrowed the category of appeals which can be brought before this Court do not demonstrate a congressional intent to alter this long-standing interpretation of the phrase "state statute" as used in 28 U.S.C. § 1257.

allocation of these wholesale power supplies and their costs. Each state understandably desires to retain as much of the inexpensive power generated within its state as possible, while shielding its citizens from the costs of more expensive sources of generation.

Under the Federal Power Act, FERC has exclusive jurisdiction over interstate wholesale power transactions and the resulting wholesale rates and costs. (Appendix (App.) 183a). FERC thus determines both the wholesale cost a utility incurs for purchasing power for resale to its customers as well as the revenues the producing utility receives for selling its power at wholesale. This case presents a direct challenge to FERC's exclusive jurisdiction over rates for wholesale power sold in interstate commerce.

The KCC reduced KG&E's retail rates by imputing to KG&E greater revenue from the wholesale interstate sale of power to the Oklahoma Municipal Power Authority (OMPA) than KG&E is permitted to (or did) collect under its FERC-filed rates. The KCC's rationale was that it was unfair for KG&E to offer "its cheapest and lowest cost capacity to another [utility], while including its highest cost capacity in rates paid by its jurisdictional, captive ratepayers." (App. 58a).

The KCC's references to the "lowest cost" and "highest cost" capacity relate to the fact that KG&E sold at wholesale to OMPA power generated from its gas-fired Gill and Evans plants. These gas-fired plants are KG&E's lowest cost sources of electric capacity, and the FERC-filed rates for this wholesale transaction reflected the low capacity costs of these facilities. KG&E's most expensive source of electric capacity is the Wolf Creek Generating Station ("Wolf Creek"), a nuclear plant, which was not included in the transaction with OMPA.[2] The KCC's view was

[2] The cost of producing electricity has several components, including the capital cost of the plant, fuel expenses, and operating

that OMPA was obtaining the benefit of KG&E's lowest cost capacity through a wholesale interstate transaction while KG&E's Kansas customers were being required to purchase the more expensive Wolf Creek capacity.

To remedy this perceived unfairness, the KCC simply pretended that the power KG&E sold to OMPA came from Wolf Creek. The KCC determined what additional revenues KG&E would have collected from OMPA if the sales had been based on Wolf Creek's costs instead of Gill's and Evans' costs. This phantom revenue, amounting to $13.5 million, was then imputed to KG&E and its intrastate retail rates were reduced by that amount.

The factor underlying this imputation of phantom revenue, and the entire OMPA transaction, is the Wolf Creek plant. Since the plant's completion in 1985, the KCC's ratemaking treatment of Wolf Creek has dominated KG&E's relationship with the KCC. The Kansas Court of Appeals concluded that there was a "close relationship between this case and the prior Wolf Creek rate case." (App. 3a). The KCC's rate treatment of Wolf Creek has previously been raised before this Court, which noted probable jurisdiction on February 23, 1987 of KG&E's appeal arising from the KCC's initial rate treatment of Wolf Creek in 1985.[3] At the KCC's request, the Court subsequently dismissed that appeal as moot when the KCC issued new orders in March 1987 modifying the rate treatment of the plant.[4] The present case springs

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and maintenance costs. Fossil fuel plants typically have lower capital costs than nuclear plants, while nuclear fuel is typically less expensive than fossil fuel. The reference to the differing "capacity" costs of Gill and Evans and Wolf Creek refers to the capital cost of those plants. Gill and Evans are older fossil plants and have a much lower capital, or "capacity," cost than the newer Wolf Creek nuclear plant.

[3] *Kansas Gas & Elec. Co. v. State Corp. Comm'n of Kansas*, 479 U.S. 1082 (1987).

[4] *Kansas Gas & Elec. Co. v. State Corp. Comm'n of Kansas*, 481 U.S. 1044 (1987).

from the KCC's initial 1985 rate treatment of Wolf Creek, its March 1987 orders revising that treatment, and KG&E's actions taken in response to those orders.

Background [5]

The Initial Wolf Creek Decision.

Like all contemporary nuclear plants, Wolf Creek cost considerably more than initially estimated. In addition, customer demand for electricity from KG&E when the plant was completed was lower than had been anticipated when construction commenced. In 1985, KG&E requested a retail rate increase to recover its investment in Wolf Creek. The KCC Chairman has described the KCC's initial response as one of "brinkmanship," where KG&E's rates were set as low as possible "without bankrupting KG&E or jeopardizing its ability to provide safe and adequate electric service." (App. 82a).

The KCC refused to include a large portion of Wolf Creek in rate base [6] because KG&E did not need that part

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[5] The background information is contained in numerous orders of the KCC spanning a five-year period. Because there is no dispute about this historical background, and because of the volume of the KCC orders, not all of these materials have been included in the Appendix. This background information is well summarized in the KCC Chairman's dissent to the February 13, 1990 order that imputed the phantom revenue to KG&E. (App. 80a). The initial Wolf Creek decision by the KCC, *Re Wolf Creek Nuclear Generating Facility*, is reported at 70 P.U.R. 4th 475 (Kan. Corp. Comm'n 1985).

[6] Rate base is a utility's undepreciated investment in the assets used to provide public service. C. Phillips, *The Regulation of Public Utilities*, 301 (2nd ed. 1988). The rates a utility is allowed to charge are determined largely by its rate base. Rate regulation sets rates at a level that provides the utility an opportunity to earn revenues to cover its operating expenses and capital costs. That level of revenues typically is defined as:

$$\text{Revenue Requirement} = \text{Operating Expenses} + (\text{Rate Base} \times \text{Weighted Average Cost of Capital}).$$

When rate base or operating expenses are reduced the utility's revenue requirement decreases and its rates are set at a lower level.

of the plant to meet its demand from customers for electricity. *Re Wolf Creek Nuclear Generating Facility*, 70 P.U.R. 4th 475, 515-16 (Kan. Corp. Comm'n 1985). In making that adjustment, the KCC recognized that part of Wolf Creek's capacity could be required to offset the retirement of KG&E's 92 megawatt (MW) Ripley Station (Ripley). It included 46 MW of Wolf Creek in rate base immediately to compensate for the retirement of Ripley. *Id.* at 514. The KCC also concluded that an additional 46 MW of Wolf Creek could be added to rate base later to replace the remainder of Ripley if KG&E demonstrated the prudence of retiring that plant. *Id.*

The resulting rate increase approved by the KCC was to be phased-in through four separate increases over several years. KG&E appealed the KCC's decision to the Kansas courts and eventually to this Court, which noted probable jurisdiction. Several other events occurred prior to that time that bear directly on this case.

The OMPA Sale.

The KCC recognized that it had accorded KG&E very harsh economic treatment in its ratemaking of Wolf Creek. (App. 124a). The KCC Chairman has stated that "we tilted the scales heavily toward KG&E's customers and challenged KG&E to figure out how to bring the scales into balance without further rate increases, if possible. . . . As an incentive to seriously face that challenge, we held KG&E's Wolf Creek rate increase to the lowest possible level." (App. 82a).

Without the option of increasing its prices, KG&E's only options for meeting the challenge imposed by the KCC were to reduce costs and to increase sales. KG&E made serious efforts to implement both options, including searching for new markets in which to sell its electricity. One successful effort was KG&E's sale to OMPA. On May 22, 1986, KG&E entered into a Participation Power Agreement with OMPA under which KG&E sold

OMPA 41.2 MW of capacity from KG&E's gas-fired Evans and Gill plants. (App. 166a). OMPA needed the purchased capacity only 14.4 percent of the time, so a sale of the much more expensive base load capacity from Wolf Creek to OMPA was not a viable option. (App. 57a).[7]

The OMPA sale was an interstate sale of wholesale power and therefore subject to FERC's exclusive jurisdiction. On May 22 and June 16, 1986, KG&E filed the Participation Power Agreement with FERC in accordance with 16 U.S.C. § 824d(c). (App. 162a). KG&E also served a copy of the agreement on the KCC at that time. In addition, FERC gave public notice of KG&E's filing in the Federal Register. Neither the KCC nor any other party intervened, filed comments or protested. *Id.* FERC, therefore, allowed the OMPA Participation Power Agreement and the accompanying wholesale rates to become effective as of July 1, 1986. (App. 163a).

The Second Wolf Creek Decision.

As KG&E negotiated and concluded the sale to OMPA, its appeals of the KCC Wolf Creek ratemaking orders proceeded through the Kansas courts. The Kansas Supreme Court affirmed the KCC's actions and KG&E appealed to this Court, arguing that the KCC's valuation of Wolf Creek and the resulting rates were so low they constituted a confiscation of KG&E's property. This Court noted probable jurisdiction on February 23, 1987.[8]

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[7] As noted above (*supra* note 2), the cost of producing electricity includes both the capital or fixed costs of a generating facility (capacity cost) and the costs of operating the facility (energy cost). Both these costs are included in the price a generator sets for its electricity. A utility that needs to purchase power only occasionally will typically be more concerned with capacity costs than with energy costs, because capacity costs remain constant but energy costs vary according to demand.

[8] *Kansas Gas & Elec. Co. v. State Corp. Comm'n of Kansas*, 479 U.S. 1082 (1987).

Very shortly thereafter, the KCC on March 11, 1987, issued another order relating to Wolf Creek that made several substantial revisions to the ratemaking treatment of that plant. (App. 121a). It made each of the four-step rate increases (some of which had not yet been implemented) permanent (App. 151a); in addition, it added the remaining revenue impact of the Ripley retirement [9] to the permanent third phase of the increase, to become effective on January 1, 1989. (App. 134a). The inclusion of revenues related to the Ripley retirement was conditioned on the following:

> [I]t is reasonable to assume that KG&E's need for Wolf Creek, whether from peak growth or reduced overall generating capability, will have grown by 41 MW from 1986 to 1988. . . . Also, as a condition precedent to the inclusion of revenues associated with the Ripley retirement in the January 1, 1989, rate increase, we direct the company to show the Commission that this . . . has occurred.

(App. 134a-35a).

On the strength of its "final" Wolf Creek ratemaking order, the KCC moved this Court on April 13, 1987, to dismiss KG&E's appeal of the initial Wolf Creek orders as moot. (App. 154a). Anticipating KG&E's argument that the case was not moot, the KCC argued:

> In this instance, the specific basis for each of the issues on appeal has been completely changed by the subsequent order making rates permanent. *Furthermore, the March 11, 1987 Commission order contemplates that the framework it establishes will govern*

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[9] The revenue impact of the Ripley retirement consisted of adding the cost of 46 MW of Wolf Creek capacity into rate base and thus into KG&E's revenue requirement. *See supra* note 6. The KCC found in a March 19, 1987 order that KG&E had acted prudently in retiring Ripley, which was one of the conditions precedent to including the additional 46 MW of Wolf Creek into rate base. (App. 27a).

the setting of KG&E's rates for the remaining operational life of Wolf Creek.

(App. 158a-59a) (emphasis added). This Court granted the KCC's motion and dismissed KG&E's appeal. *Kansas Gas & Elec. Co. v. State Corp. Comm'n of Kansas*, 481 U.S. 1044 (1987).

The KCC Proceedings at Issue.

Under the ratemaking structure the KCC adopted in its March 13, 1987 order—the framework it told this Court would govern the setting of KG&E's rates for the remaining life of Wolf Creek—the third phase of the Wolf Creek rate increase was to take permanent effect on January 1, 1989. At that time, 46 MW of Wolf Creek would be added to rate base to replace the remainder of Ripley if KG&E could demonstrate that during 1986-88 it had experienced either a growth in peak demand or a reduction in generating capability totalling 41 MW. In a December 30, 1988 order, the KCC concluded that KG&E had in fact met the 41 MW condition and thus inclusion of 46 MW of Wolf Creek in the third-phase rate increase was appropriate. (App. 106a).

Despite its prior statements concerning the permanent status of these rates, the KCC refused to make the 46 MW of Wolf Creek portion of the third-phase increase permanent. Rather, it made this $14.4 million part of the increase interim and subject to refund, pending the results of an audit of KG&E's cost of service. (App. 105a).

The KCC Staff conducted an audit of KG&E's cost of service during 1989 and concluded that KG&E's revenues were $18.4 million less than its cost of serving its retail customers. The Staff recommended that the Wolf Creek-related $14.4 million increase be made permanent. (App. 34a). KG&E's own cost of service study showed an even greater revenue deficiency, but KG&E concurred with the Staff recommendation. *Id.*

Intervenor Citizens' Utility Ratepayers Board ("CURB"), a consumer advocate organization, proposed that KG&E's revenue requirement be *reduced* by $51.3 million. CURB's proposal was based on several adjustments to KG&E's actual operating results, including the imputation to KG&E of an additional $13.5 million from the OMPA sale. This phantom revenue reflected the additional revenue KG&E would have received had it sold electricity from Wolf Creek to OMPA, rather than electricity from its gas-fired Gill and Evans plants. (App. 34a, 56a).

The KCC accepted CURB's proposed imputation of $13.5 million of phantom wholesale revenues and ordered KG&E to reduce its retail rates. The KCC reasoned that the imputation was appropriate to protect KG&E's retail Kansas customers, because KG&E's sale to OMPA was "a case of one utility selling its cheapest and lowest cost capacity to another, while including its highest cost capacity in rates paid by its jurisdictional, captive ratepayers." (App. 58a). The KCC believed that unfairness to be enhanced by KG&E's use of the off-system sale to justify in part the inclusion of the additional 46 MW of Wolf Creek capacity in its rates to replace Ripley.[10] The KCC concluded that, although it had encouraged KG&E to seek off-system sales like the OMPA sale, it would not

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[10] As noted above, the KCC concluded in its December 30, 1989 order that KG&E had met the condition precedent for including the additional Wolf Creek capacity in the third-phase increase. (App. 106a). The condition precedent was disjunctive: KG&E could meet it by showing a 41 MW increase in peak demand *or* a 41 MW reduction in generating capability. The KCC found in its February 13, 1990 order that KG&E had used the OMPA sale to meet the reduced generating capability part of the condition precedent. (App. 58a). KG&E had also met the part of the condition precedent relating to an increase in peak demand. (App. 104a, 106a). The KCC concluded in its February 13, 1990 order, however, that KG&E had improperly used interruptible sales contracts to meet this condition. (App. 55a).

condone such sales "if their effect is to increase rates for Kansas customers. . . ." *Id.*

On March 5, 1990, KG&E filed a Petition for Reconsideration with the KCC. Among other grounds, KG&E presented the KCC with the following:

> The Commission's Finding at Paragraphs 26, Pages 38 through 41, That Decreases KG&E's Revenue Requirement By Imputing $13.5 Million of Additional Revenue to KG&E's Off-System Sale to the Oklahoma Municipal Power Authority (OMPA) Is Unconstitutional Under the Supremacy Clause of the Constitution.

KG&E Petition for Reconsideration, March 5, 1990, p. 13. On March 21, 1990, the KCC entered an order denying KG&E's Petition for Reconsideration (App. 100a).

The Kansas Court of Appeals Decision.

On April 2, 1990, KG&E applied for judicial review of the KCC's order by the Kansas Court of Appeals. In its application, KG&E presented the following question to the court of appeals:

> Whether the Challenged Orders Are Unlawful Because They Impute Revenue To A Federally Regulated and Approved Wholesale Power Contract in Violation Of The Supremacy Clause of the United States Constitution.

KG&E's Brief of Appellant, April 23, 1990, p. 2.

The court of appeals entered its opinion in the case below on June 29, 1990. (App. 1a). After devoting several pages to an analysis of FERC's exclusive jurisdiction over wholesale power rates and the corollary filed rate doctrine, the Kansas Court of Appeals concluded that the filed rate doctrine only "ensures that the *buyer* of the wholesale power is allowed to recover its approved costs from the ratepayer." (App. 18a) (emphasis added).

The court reasoned that because previous applications of the filed rate doctrine involved purchasers of wholesale power, the doctrine had no relevance to a case involving state regulation of a seller of wholesale power in interstate commerce. *Id.* The Kansas Court of Appeals affirmed the KCC's imputation of additional revenues to the OMPA sale. (App. 19a).

On July 20, 1990, KG&E petitioned the Kansas Supreme Court to review the court of appeals decision. KG&E presented the following question for the Kansas Supreme Court's review:

> Whether The Court Erred in Permitting An Imputation of Revenues to An Off-System Sale Subject to FERC's Jurisdiction In Disregard of Preemptive Effect Accorded the Determination of the FERC Under The Supremacy Clause of the United States Constitution.

Petition for Review by Appellant KG&E, July 20, 1990, p. 2.

The Kansas Supreme Court denied KG&E's Petition for Review on September 20, 1990. (App. 24a).

REASONS FOR GRANTING THE WRIT

I. THE QUESTION PRESENTED IS OF NATIONAL IMPORTANCE

More than half a century ago, Congress in enacting Section II of the Federal Power Act recognized the importance of wholesale interstate power transactions to the welfare of the nation. To foster such transactions, Congress developed comprehensive federal regulation designed to insulate wholesale interstate power sales from the inconsistencies and parochialism inherent in state regulation.[11] Congress' foresight was astute; a foundation of the industrialization and economic development of the United States has been the availability and reliability of bulk power supplies. The transfer of wholesale power from differing sources into interstate commerce for resale in different states has become a common element of the national economy.

Given the current and projected status of the nation's power supply, interstate power transactions are becoming increasingly necessary to maintain a baseline level of power availability. The demand for electricity continues to grow in this country, but very few electric utilities are building plants to meet this demand. Having witnessed the treatment by state regulators of new plant costs over the last decade, a process in which utilities were denied recovery of billions of dollars of their investments, many utilities are hesitant to put additional cap-

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[11] When Congress enacted the Federal Power Act in response to *Pub. Utils. Comm'n v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927), where this Court held that the Commerce Clause limited state regulatory authority over interstate sales of power at wholesale, Congress did more than fill that regulatory gap with a federal presence. Congress completely excluded state regulation of such transactions, effectively replacing the flexible balancing test used to limit state authority to affect interstate commerce with a bright line separating federal and state authority. *See FPC v. Southern California Edison Co.*, 376 U.S. 205, 212-216 (1964).

ital at risk in new construction programs.[12] As a result, the threat of near-term shortfalls of electric capacity on the order of hundreds of thousands of megawatts is very real.[13]

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[12] Between 1980 and 1986, state regulators disallowed more than $6 billion (approximately 10 percent) of utilities' investments in new plant construction from inclusion in rate base. Oak Ridge National Laboratory, *Prudence Issues Affecting the U.S. Electric Utility Industry*, pp. 3, 43-44 (December 1987). The Oak Ridge study concluded that:

> Cost disallowances for many utilities threaten the economic health of the companies. The disallowances, which deny full construction cost recovery to utilities, have had a negative effect on the ordering of any new base load power plants, either nuclear or coal. They have contributed to the fact that no nuclear plants have been ordered since 1978, and none are currently being planned in the U.S. This situation has led to a major national concern that adequate, reliable and economic electric power may not be available to meet future needs of the country.

Id. at v.

The Department of Energy also has recognized the chilling effect that recent regulatory practice is having on utility investment in generating capacity:

> The present climate of utility regulation in many states discourages new capital investment, and this restricts the range of new supply options that might otherwise be considered. A fundamental responsibility of a utility regulator is to balance customers' welfare with that of company stockholders; but in recent years the traditional compact in such regulation (which balanced limited risks with limited rewards) has been broken.

U.S. Dep't of Energy, *Energy Security—A Report to the President of the United States*, p. 154 (March 1987). *See also In re Boston Edison Co.*, Docket No. 85-266A (Mass. Dep't of Pub. Util., June 26, 1986) (utility refused to construct new generating capacity in order to avoid the risk of having its substantial construction costs disallowed by state regulators).

[13] The United States Energy Information Administration (EIA) expects sales of electricity to grow 2.3 percent annually through the year 2010, reaching 4300 terawatthours (billions of kilowatt-hours). Based on its analysis of demand for electricity and the ability of utilities to meet this demand, the EIA recently projected

Despite the projected national power supply shortage, some utilities have more capacity to generate electricity than they need to serve their own customers. Through wholesale and interstate power sales, these utilities can mitigate a national shortfall by helping others supply the requirements of their customers. Transactions between those with additional capacity and those without sufficient capacity will be increasingly important as the nation's power supply dwindles.

The feasibility of such transactions decreases, though, when parochial state concerns are permitted to intrude. The states in competitively seeking industry, commerce, labor, and other fundamental elements of the nation's economy, have a narrower view of the public good than is required to meet national needs. Those narrow interests have prompted states in recent years to attempt to alter the terms of interstate transactions by reserving the benefits of inexpensive hydropower for their citizens, *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), and by rejecting an allocation of nuclear plant costs that would increase their citizens' rates. *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988).[14] The same type of narrow

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that "the need for additional capacity *beyond what utilities have announced* ranges from 183 to 267 gigawatts by 2010." U.S. Energy Information Administration, *Annual Outlook for U.S. Electric Power 1990*, pp. 9-10 (June 1990) (emphasis added). Similarly, the Utility Data Institute, Inc., projects that the nation will need between 100,000 and 200,000 MW of new generating capacity by the year 2000; despite these projected increases in demand, utilities have planned to add less then 40,000 MW by that time and only 16,000 MW is actually under construction. *UDI: U.S. Generating Capacity Won't Meet Demand by 2000*, Electric Light & Power, June 1990 at 54.

[14] Another parochial state approach to regulation of the electric industry was addressed in *New England Power Co. v. New Hampshire*, 455 U.S. 331 (1982), where this Court overturned an order by the New Hampshire Utilities Commission that prohibited out-of-state sales of New England Power's inexpensive hydroelectric

interest prompted the KCC here to impute revenue in an interstate wholesale transaction to KG&E; in a straightforward display of protectionism, the KCC concluded that the interstate sale was unfair to the citizens of Kansas because the inexpensive capacity was being sold interstate while more expensive capacity was being charged to in-state customers.

FERC has been given exclusive jurisdiction over interstate and wholesale transactions to avoid this type of inconsistent and hostile state regulation that detracts from the overall national interest. *Jersey Cent. Power & Light Co. v. FPC*, 319 U.S. 61, 68 (1943). This Court has in recent years provided guidance on the parameters of the distinct spheres of regulation accorded to FERC and to the states. *See Mississippi Power*, 487 U.S. 354 (1988); *Nantahala*, 476 U.S. 953 (1986).[15] Although the Court in these decisions clearly defined FERC's jurisdiction as exclusive, there is evidence that state regulators have not heeded the message. In a recent industry publication, the heads of 14 local regulatory commissions were given a forum to address the issues and problems facing the utility industry. They were asked whether, in light of the increasingly regional or national nature of utility activities, FERC was "swallowing up state regulation."

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power. *Id.* at 335-36. The only difference between *New England Power* and this case is that New Hampshire attempted to further its own interests by prohibiting exportation of cheap power, whereas Kansas sought the same by exacting an economic penalty for interstate sales of inexpensive power.

[15] *Mississippi Power* and *Nantahala* specifically address the preemptive force of FERC's ratemaking authority and thus are of particular relevance to this case. This Court, however, has clearly defined the separation between FERC's exclusive jurisdiction and the authority of the states in other regulatory areas. *See, e.g., California v. FERC*, 110 S. Ct. 2024 (1990) (preemptive effect of FERC's establishment of minimum stream flow rates for hydroelectric project); *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293 (1988) (FERC's exclusive authority over the capital structure of regulated utility).

The 1990 Utility Regulators' Forum, Public Utilities Fortnightly, November 8, 1990 at 37. Several of the responses indicated that state regulators are reluctant to accept the full scope of FERC's authority.

For example, the Chairman of the Tennessee Public Service Commission responded that "[f]ederal agencies are too often too willing to preempt state regulation." *Id.* The President of the North Dakota Public Service Commission opined that "FERC is swallowing up significan areas of state regulation." *Id.* at 42. Similarly, Chairman Worthy of the District of Columbia Public Service Commission conceded that "[n]ational regulatory interests do not always coincide with local regulatory interests" and observed, with apparent regret, that "[t]he state/federal regulatory structure of the energy utility industry creates opportunities for FERC to continually exert jurisdiction. . . ." *Id.* at 43. In Chairman Worthy's view, state regulatory authority "is similar to the concept of representation of the people and by the people. This localization of regulatory functions serves to prevent regulation by the fiat of the federal government." *Id.*

The decision of the Kansas Court of Appeals also demonstrates that the respective limits of state and federal regulation are not well understood, or perhaps still not well accepted, by the states. That court's approval of an imputation of revenue to a wholesale seller of power in interstate commerce, based on an interpretation of the Federal Power Act limiting FERC's exclusive jurisdiction solely to purchasers, has serious ramifications for the wholesale interstate power market. This interpretation removes FERC's authority to regulate the actions of wholesale sellers and effectively transfers that regulatory authority to the states. In effect, this interpretation of the Federal Power Act essentially empowers the states to determine the rate structure for interstate power sales guided by the needs and desires of their citizens and without regard to the national interests at stake.

The KCC's exercise of authority is incompatible with the congressional purpose behind the enactment of the Federal Power Act. Above all else, Congress intended to create a uniform system of regulation to promote the orderly development of the interstate power market necessary for the nation's economic growth. That objective cannot be achieved if, as the court below held, the states are not bound by FERC's determinations that affect the retail activities of a seller of wholesale power.

Resolution of the conflict concerning FERC's authority over wholesale sellers is a matter of great national significance. Interstate and wholesale power transactions between utilities have been and will continue to be an important and integral part of the national economy. The decisions by utilities relating to those transactions are being made in reliance on FERC's exclusive jurisdiction over such arrangements. State commissions like the KCC are continuing to impose a "rate structure" and an allocation of costs between states that will "benefi[t] its residents to the detriment of its neighbors." [16] This issue should be resolved now.

II. THE FEDERAL POWER ACT PREEMPTS KANSAS' IMPUTATION OF REVENUE TO INTERSTATE POWER SALES

Congress provided for exclusive federal jurisdiction over interstate and wholesale electric transactions so that exchanges important to the national economy would not be impaired by state action. To avoid this impairment, FERC has been vested with exclusive jurisdiction under the Federal Power Act to regulate the rates for electric energy "for resale," to regulate the "transmission of electric energy in interstate commerce," and to allocate whole-

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[16] *Massachusetts v. United States*, 729 F.2d 886, 888-89 (1st Cir. 1984); *See Middle South Energy, Inc. v. Arkansas Pub. Utils. Comm'n*, 772 F.2d 404, 416-17 (8th Cir. 1985), *cert. denied*, 474 U.S. 1102 (1986).

sale power supplies and their costs among utilities in different states. 16 U.S.C. § 824. (App. 183a-88a). FERC thus determines, based on rate schedules filed with or approved by it, the wholesale rate a utility may charge for selling power to another for resale.

Despite these statutory provisions, the Kansas Court of Appeals has held that in setting retail rates for utilities engaged in selling power at wholesale, state regulatory commissions have unlimited discretion to ignore the FERC-filed rates governing wholesale transactions. Under the court's holding, a state regulator may pretend, for purposes of intrastate retail ratemaking, that the wholesaling utility received more revenue for the interstate sale than it was permitted to under its FERC-filed rates. (App. 18a). The Kansas court found that pretense permissible when the state regulator concludes that the interstate sale is "a case of one utility selling its cheapest and lowest cost capacity to another, while including its highest cost capacity in rates paid by its jurisdictional, captive ratepayers." (App. 58a).

This regulation by pretense, which results in unrecoverable "trapped costs," [17] conflicts with the decisions of this Court and with the intent of the Federal Power Act.

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[17] Trapped costs occur when state regulators set retail rates that prohibit full recovery of the revenue requirement generated by FERC-approved wholesale arrangements. In *Nantahala*, the FERC-mandated expense of purchasing wholesale power was trapped. *Nantahala*, 476 U.S. at 971-72. In this case, the KCC's order traps the cost of producing power instead of the cost of purchasing power. FERC allows KG&E to charge OMPA only for the cost of power generated at the Evans and Gill plants. That wholesale rate structure makes the cost of producing a like amount of power at Wolf Creek a part of KG&E's retail revenue requirement. *See supra* note 6. The KCC prevented KG&E from recovering those Wolf Creek costs by pretending that FERC had allowed them to be charged to OMPA. Thus, as in *Nantahala*, KG&E is left with unrecoverable costs because it is bound by FERC-filed rates that the state regulators disregarded.

The Federal Power Act preempts state regulators from "directly" or "indirectly" regulating interstate wholesale rates that are subject to FERC's jurisdiction. *See N. Natural Gas Co. v. State Corp. Comm'n*, 372 U.S. 84, 90-92 (1963).[18] To ensure complete adherence to wholesale rates regulated by FERC, this Court established the filed rate doctrine. Under that doctrine, state regulators and utilities:

> can claim no rate as a legal right that is other than the filed rate, whether fixed or merely accepted by the Commission, and not even a court can authorize commerce in the commodity on other terms. . . .
>
> [T]he right to a reasonable rate is the right to the rate which the [FERC] files or fixes and . . . the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more responsible one.

Montana-Dakota Utils. Co. v. Northwestern Pub. Serv. Co., 341 U.S. 246 (1951).

Despite the clear holding in *Montana-Dakota*, the Kansas Court of Appeals authorized the KCC to assume that "commerce in the commodity on other terms" had in fact occurred. While agreeing that the filed rate doctrine would preclude a state from prohibiting full recovery of the costs a wholesale purchaser pays under a FERC rate, the court concluded that the doctrine did not apply to sellers of wholesale power that recover the FERC rate. The Kansas Court distinguished this case from *Nantahala* and *Mississippi Power* through a narrow construction of this Court's decisions that limited the filed rate doctrine to wholesale purchasers.[19]

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[18] Although *N. Natural Gas* was decided under the Natural Gas Act and not the Federal Power Act, this Court has recognized that the two statutes are substantially identical and therefore cites interchangeably cases arising under both Acts. *Arkansas-Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n. 7 (1981).

[19] An additional ground cited by the court below for upholding the KCC's order was that the KCC was not regulating the same

This mechanistic view of FERC's jurisdiction as unilateral misapprehends the nature of the filed rate doctrine and the preemptive force of FERC's jurisdiction. The fundamental principle underlying the filed rate doctrine's application to state action is that " 'there can be no divided authority over interstate commerce, and . . . the acts of Congress on that subject are supreme and exclusive.' Consequently, state efforts to regulate commerce must fall when they conflict with or interfere with federal authority over the same activity." *Chicago & N. W. Transp. Co. v. Kalo Brick & Tile Co.*, 450 U.S. 311, 318-19 (1981) (quoting *Missouri Pac. R. R. Co. v. Stroud*, 267 U.S. 404, 408 (1925)). If state regulation undermines or interferes with FERC's exclusive jurisdiction over wholesale interstate sales, regardless of whether the interference affects a purchaser or a seller, the state regulation cannot stand. *See Appalachian Power Co. v. Pub. Serv. Comm'n of West Virginia*, 812 F.2d 898, 904-05 (4th Cir. 1987).

In *Nantahala* and *Mississippi Power*, this Court overturned attempts by state authorities to establish retail rates for intrastate sales of power which did not give

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activity as FERC. (App. 19a). The basis for that conclusion was that the KCC's actions did not prevent KG&E from selling power to and collecting its FERC-filed rate from OMPA. (App. 18a). The fact that the state action does not require KG&E to violate FERC's order does not save the KCC's order from the preemptive effect of FERC's jurisdiction. This Court squarely rejected that argument in *Nantahala*. *See Mississippi Power*, 487 U.S. at 371. The Kansas court's reasoning ignores the well-established precept that federal preemption of state action does not require that compliance with both the federal and state laws be impossible. The Supremacy Clause also prohibits state action that "stands as an obstacle to the accomplishment of the full purposes and objectives of Congress." *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 300 (1988); *See also Appalachian Power Co. v. Pub. Serv. Comm'n of West Virginia*, 812 F.2d 898, 904 (4th Cir. 1987) ("Preemption principles deny state authority to act in a way that would undermine the purposes of federal law.")

full effect to FERC-filed rates that affected the utilities' cost of retail service. Applying the filed rate doctrine, this Court held that the states' departures from the FERC-filed rates obstructed accomplishment of Congress' intent in the Federal Power Act and thus violated the Supremacy Clause. *Mississippi Power*, 487 U.S. at 373; *Nantahala*, 476 U.S. at 966-67.

In limiting FERC's authority on the basis of the buyer-seller distinction, the Kansas court failed to grasp that the central focus of *Nantahala* and *Mississippi Power* is the potential for state action to erode FERC's authority. The impact of state action on FERC's authority does not depend on whether the object of the state regulation is a buyer or a seller. Identical economic impacts result from a state regulator's imputation of fictitious wholesale revenues to a utility and from a regulator's pretense that a utility's wholesale power costs are lower than they actually are. Both fictions artificially reduce the utility's retail revenue requirement, allowing state regulators to fix rates to in-state customers at a level that does not accurately reflect the FERC-filed rates paid or collected.

In fact, state regulation of wholesale sellers is potentially more intrusive on FERC's jurisdiction than state regulation of wholesale purchasers. Congress' intent in passing the Federal Power Act was to provide for federal regulation of sellers of wholesale power, not buyers. *See Gulf States Utils. Co. v. FPC*, 411 U.S. 747, 758 (1973). Moreover, there arguably may be areas related to purchasers of wholesale power in which state regulatory power may operate, such as the prudence of the amount and source of the wholesale power bought. *See, e.g., New Orleans Pub. Serv., Inc. v. Council of New Orleans*, 911 F.2d 993, 1002 (5th Cir. 1990); *Pike County Light & Power Co. v. Pennsylvania Pub. Util. Comm'n.*, 77 Pa. Commw. 268, 273-74, 465 A.2d 735, 737-38 (1983). FERC's jurisdiction is less threatened

when a state inquires into the wisdom of the purchasers' decision to enter into a transaction than when a state attempts to review the economic fairness of a wholesale transaction. In this case, the KCC has intruded on the precise issue the Federal Power Act commits to FERC—whether the cost recovery from the OMPA sale was just and reasonable. *See* 16 U.S.C. § 824e(a). *Cf. FPC v. Sierra Pac. Power Co.*, 350 U.S. 348, 355 (1956) (FERC (then the FPC), in fixing just and reasonable rates, may consider whether a wholesale rate casts an excessive burden on seller's other customers).

This usurpation of FERC's prerogative is totally at odds with the preemption principles announced in *Nantahala* and *Mississippi Power* and is precisely what the filed rate doctrine prohibits. This Court held there that the filed rate doctrine requires state regulators to give *full* effect to FERC-filed wholesale rates when fixing retail rates:

> Once FERC sets such a rate, a state may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. A state must rather give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the states do not interfere with this authority.

Nantahala, 476 U.S. at 966. *Accord Mississippi Power*, 487 U.S. at 374 ("states may not regulate in areas where FERC has properly exercised its jurisdiction to determine just and reasonable wholesale rates or to ensure that agreements affecting wholesale rates are reasonable.").[20]

[20] This principle has special applicability here, where a state has redesigned a wholesale transaction to benefit its own citizens. The Federal Power Act was enacted as a "direct result" of this Court's holding in *Pub. Utils. Comm'n v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927), in which the Court recognized that states could disrupt interstate transactions if allowed to regulate such trans-

FERC's authority cannot be plenary if the states in setting retail rates retain the power to disregard the wholesale revenues FERC fixes or allows. Retail rates must reflect those wholesale costs and revenues if the utility is to maintain its financial footing. Permitting the states to set retail rates by altering the FERC-filed revenue collected by the utility is tantamount to permitting the states to regulate interstate sales of electricity at wholesale. To avoid the trap in which KG&E is caught, exposed to having a portion of its costs permanently trapped by the KCC's refusal to give full effect to KG&E's FERC-filed rates, wholesalers will have to look to local regulators before making an interstate sale of power. State regulators, not FERC, will make the effective determination of what wholesale power sales are appropriate based on their concern for furthering local interest. Such a result is wholly inconsistent with the congressional objective embodied in the Federal Power Act and the preemptive force given that legislative intent by the Supremacy Clause.

Giving full effect to Congress' grant of plenary authority to FERC requires a recognition that in fixing or allowing rates, FERC necessarily has jurisdiction over both sides of the buy-sell equation. FERC's authority under the Federal Power Act is limited to fixing or allowing "just and reasonable" rates (App. 184a), which requires that a seller receive no more than a fair price for what it actually sells. The KCC's imputation of phantom revenue, accomplished by including items in an interstate sale not considered by FERC when it allowed the rate, interferes with FERC's mandate to set just and reasonable rates. When the effect of state action is to interfere with FERC's authority, the state action is pre-

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actions in furtherance of their "respective local interests." *Id.* at 89-90. *See Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S 375, 378 (1983).

empted. *Maryland v. Louisiana,* 451 U.S. 725, 746-52 (1981).

The Kansas court, by reading *Nantahala* and *Mississippi* narrowly and limiting the principles in those cases to the specific facts presented there, concluded that no interference with FERC's jurisdiction existed. That court's decision to examine preemption issues on a case-by-case basis in an attempt to avoid finding preemption is inconsistent with the intent of Congress in enacting the Federal Power Act:

> Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction making unnecessary . . . case-by-case analysis. This was done in the Power Act by making FPC jurisdiction plenary and extending it to all wholesale sales in interstate commerce. . . .

FPC v. Southern California Edison Co., 376 U.S. 205, 215-16 (1964).

By imputing phantom revenue to the OMPA sale, Kansas crossed over this bright line. The KCC rejected KG&E's FERC-filed rate and applied instead a fictitious wholesale power rate specifically designed to benefit KG&E's in-state ratepayers. In doing so, the KCC determined for itself what constituted a fair rate for KG&E's sale of power to OMPA. The Federal Power Act requires that FERC, not an affected state, make such decisions. The KCC, like all state regulators, will always be able to find that some part of an interstate transaction unfairly burdens its fellow citizens and unfairly benefits the citizens of another state.[21] The "bright

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[21] Section 206 of the Federal Power Act, 16 U.S.C. § 824e (App. 186a), provides state regulators and consumer advocates with ample opportunity to challenge the reasonableness of a wholesale transaction. Despite the availability of such proceedings and despite its current claim that the OMPA sale unfairly burdens Kansas ratepayers, the KCC and CURB made no effort to seek redress through the procedures of the Federal Power Act. Having failed to do so, the KCC was precluded from considering CURB's collateral attack on the fairness of the OMPA sale, even as to matters

line" of FERC's plenary jurisdiction was intended to remove such state interests from the regulation of interstate power transactions.

If the flow of power across state lines is to continue unimpaired, the conflict between FERC's authority over sellers of wholesale power and state attempts to shape wholesale rate structures to further their parochial interests should be resolved now.

CONCLUSION

The Court should grant a Writ of Certiorari and set the case for full briefing and argument on the merits. The federal issue is too important, and has too great an impact on interstate wholesale power sales, for the Kansas courts and regulators to be permitted to ignore the supremacy of federal law unimpeded.

Respectfully submitted,

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December 19, 1990

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not actually raised before FERC. *Mississippi Power*, 487 U.S. at 374-75. *Cf. City of Tacoma v. Taxpayers of Tacoma*, 357 U.S. 320, 334-37 (1958) (Federal Power Act's specific provisions for judicial review necessarily preclude any other form of judicial review or *de novo* litigation of all matters involved in the controversy).

90-984 (2)
No.—

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

KANSAS GAS AND ELECTRIC COMPANY,
Petitioner,
v.

STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS, et al.,
Respondent.

Petition for a Writ of Certiorari to the Court of Appeals of the State of Kansas

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APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

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APPENDIX A

Opinion of the Court of Appeals of the State of Kansas (June 29, 1990)

IN THE COURT OF APPEALS
OF THE STATE OF KANSAS

No. 64,976
No. 65,041

KANSAS GAS AND ELECTRIC COMPANY,
Appellant,

v.

STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS,
Appellee.

BEECH AIRCRAFT CORPORATION, *et al.*,
Appellants,

v.

STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS,
Appellee.

MEMORANDUM OPINION

Appeal from the Kansas Corporation Commission. Opinion filed June 29, 1990. Affirmed in part and reversed in part.

Gerald R. Deaver, *J. Michael Peters*, and *Ralph B. Foster*, of Wichita, for appellant Kansas Gas and Electric Company.

Curtis M. Irby, of Bonwell, Foster, Irby & Ellis, of Wichita, for appellants Beech Aircraft Corporation, The Coleman Company, Inc., LaFarge Corporation, Total Petroleum, Inc., and Texaco, Inc.

Frank A. Caro, Jr., general counsel, *Dana A. Bradbury*, and *Susan A. Gilroy*, assistants general counsel, of Kansas Corporation Commission, for appellee.

William G. Riggins, consumer counsel, of Topeka, for intervenor Citizens' Utility Ratepayers Board.

Before ABBOTT, C.J., REES and DAVIS, JJ.

Per Curiam: Kansas Gas and Electric Company (KG&E) appeals the Kansas Corporation Commission's (KCC) order that KG&E reduce its rates prospectively by $8,677,386 and institue an annual refund of the same amount, with interest from January 1, 1989. Beech Aircraft Corporation, The Coleman Company, Inc., Total Petroleum, Inc., LaFarge Corporation, and Texaco, Inc., (industrial intervenors) join this appeal as appellants.

The first issue is whether this court has jurisdiction to hear the appeal. K.S.A. 1989 Supp. 66-118a(b) provides, in relevant part: "The court of appeals shall have exclusive jurisdiction to review any agency action of the state corporation commission arising from a rate hearing requested by a public utility or requested by the state corporation commission when a public utility is a necessary party." KG&E is a public utility, as defined in K.S.A. 66-104, *i.e.*, it is a company "for the production, transmission, delivery or furnishing of heat, light, water or power." The question is whether the agency action arises from a rate hearing.

The contested KCC orders were the result of technical hearings held November 1 and 2, 1989. The hearings involved a determination whether a portion of KG&E's rates effective January 1, 1989, should go into effect as originally ordered. These rates reflected the addition of the revenue impact resulting from the retirement of Rip-

ley Generating Station to the third phase-in increase based upon bringing Wolf Creek Generating Station (Wolf Creek) on line. The agency action arose directly from the rate hearings on November 1 and 2, 1989, which had roots in the original Wolf Creek rate case. The close relationship between this case and the prior Wolf Creek rate case leaves little question that the agency action arises from a rate hearing. See *In re Application of Southwestern Bell Tel. Co.*, 9 Kan. App. 2d 525, 529-31, 685 P.2d 304, *rev. denied* 236 Kan. 875 (1984) (discussion of the application of 66-118a[b]), and *MAPCO Intrastate Pipeline Co. v. Kansas Corporation Comm'n*, 10 Kan. App. 2d 527, 529-31, 704 P.2d 989 (1985) (further consideration of meaning of phrase "arising from a rate hearing"). We are satisfied that we have jurisdiction.

In order to understand the issues, some background information is set out. In 1985, construction was completed on Wolf Creek. KG&E took a 47 percent share in the project and, along with the other investors, applied for rate increases to reflect commercial operation of the plant. These rate increases, granted on an interim basis, were affirmed on appeal in *Kansas Gas & Electric Co. v. Kansas Corporation Comm'n*, 239 Kan. 483, 720 P.2d 1063 (1986).

KG&E's increases were granted in four increments in orders issued on September 27 and November 15, 1985, as follows:

YEAR	AMOUNT	
1985	$135,000,000	
1986	20,000,000	
1987	14,600,000	
1988	15,600,000	(5 years to cover deferred phase-in revenues.)

The third increase originally scheduled to take effect in 1987 is the subject of the current appeal.

KG&E sought to add the revenue impact of the Ripley Generating Station retirement to the third increase. In an order issued March 11, 1987, the KCC permitted KG&E to delay the third increase until January 1, 1989, and add the revenue impact of the Ripley retirement to the increase, with the entire increase to be effective on a permanent basis with one condition. That condition was that, before the increase went into effect, KG&E had to show a 41 megawatt (MW) "demand growth or reduced overall generating capacity [had] occurred." This brought the third increase to $29,000,000 rather than the original $14,600,000. The fourth increase was delayed until January 1, 1992. The March 11, 1987, order is referred to as the Rate Stabilization Order. That order's findings were adopted and reaffirmed in a March 19, 1987, order approving the retirement of the Ripley Generating Station. In an order issued July 15, 1988, modifying the KCC's Rate Stabilization Order, the January 1, 1992, increase was eliminated, but the order reiterated the third increase.

Before the hearing on whether KG&E met the 41 MW contingency, the Citizens' Utility Ratepayers Board (CURB) filed a motion to have the Ripley impact portion of the permanent third-phase increase changed to interim and subject to refund. CURB contended that the portion of the increase adding the revenue impact of the Ripley retirement had not been granted pursuant to proper procedure. After the hearing, limited in scope to whether KG&E met the required contingency, the KCC issued an order December 30, 1988, stating the 41 MW condition had been met. The KCC, however, changed the permanent status of the increase attributable to the Ripley retirement ($14,400,000) to interim and subject to refund. The order also directed the KCC staff to perform an audit of KG&E's rates. KG&E appealed the KCC's order changing the status of the rates and that issue was decided by this court in *Kansas Gas & Electric Co. v. Kansas Corp. Comm'n*, No. 63,400, unpublished opinion filed June 4,

1990. As a result of that decision, two of the issues raised in this appeal are moot.

In July 1989, the KCC staff completed its audit and recommended that KG&E be allowed to retain the $14,400,000 rate increase attributable to the Ripley retirement. The audit showed that, even after including the $29,000,000 third phase-in increase, KG&E still had a revenue deficiency of about $18,400,000. This is based upon a return on equity of 12.53 percent.

Public and technical hearings were held in November 1989. The technical hearings incorporated testimony regarding the interim rates and rate-design issues raised by CURB. The KCC then made the following orders:

> "1. The application of the Kansas Gas & Electric Company, to make permanent the $14.4 million portion, of a $29 million rate increase, related to the retirement of the Ripley Steam Electric Station and made interim and subject to refund by order of this Commission on December 30, 1988, is granted in part and modified in part by the Commission;
>
> "2. KG&E shall reduce it's [*sic*] rates prospectively, for all rate classes, by $8,677,386 to reflect adjustments to KG&E's revenue requirement proposed by intervenor, CURB, and adopted by this Commission;
>
> "3. KG&E shall institute an across-the-board, annual refund of revenues in the amount of $8,677,386 plus interest, collected from January 1, 1989, until such time as KG&E's new rates become effective;
>
> "4. KG&E shall reduce it's [*sic*] customer service charges and increase its energy charges to levels proscribed [*sic*] by the Commission in this order;
>
> "5. KG&E will file tariffs with this Commission to reflect the adjustments made to its Conservation Use Rate as set out in this order."

K.S.A. 77-603 extends the Act for Judicial Review and Civil Enforcement of Agency Actions to all agencies not specifically excluded. Actions by the KCC are not excluded. This act places the burden of proving the invalidity of agency action on the party challenging the action. K.S.A. 77-621(a)(1). Relief may be granted by the court only if one or more of the following determinations is made:

"(1) The agency action, or the statute or rule and regulation on which the agency action is based, is unconstitutional on its face or as applied;

"(2) the agency has acted beyond the jurisdiction conferred by any provision of law;

"(3) the agency has not decided an issue requiring resolution;

"(4) the agency has erroneously interpreted or applied the law;

"(5) the agency has engaged in an unlawful procedure or has failed to follow prescribed procedure;

"(6) the persons taking the agency action were improperly constituted as a decision-making body or subject to disqualification;

"(7) the agency action is based on a determination of fact, made or implied by the agency, that is not supported by evidence that is substantial when viewed in light of the record as a whole, which includes the agency record for judicial review, supplemented by any additional evidence received by the court under this act; or

"(8) the agency action is otherwise unreasonable, arbitrary or capricious." K.S.A. 77-621(c).

Case law provides additional guidance on this court's review of the KCC's actions.

"The legislature has vested the commission with wide discretion and its findings have a presumption

of validity on review. [Citation omitted.] Since discretionary authority has been delegated to the commission, not to the courts, the power of review does not give the courts authority to substitute their judgment for that of the commission. [Citation omitted.] The commission's decisions involve the difficult problems of policy, accounting, economics and other special knowledge that go into fixing utility rates. It is aided by a staff of assistants with experience as statisticians, accountants and engineers, while courts have no comparable facilities for making the necessary determinations. [Citation omitted.] Hence a court may not set aside an order of the commission merely on the ground that it would have arrived at a different conclusion had it been the trier of fact. It is only when the commission's determination is so wide of the mark as to be outside the realm of fair debate that the court may nullify it." *Midwest Gas Users Ass'n v. Kansas Corporation Commission*, 3 Kan. App. 2d 376, 380-81, 595 P.2d 735, *rev. denied* 226 Kan. 792 (1979).

Substantial Competent Evidence

KG&E, in its Issue III, contends that an administrative agency may depart from its prior orders only if the new order is supported by substantial competent evidence and the changes are rationally and explicitly justified in the order. KG&E relies upon a case outside this jurisdiction for that proposition. Thus, KG&E separates the asserted two requirements into two issues. In Issue III, it addresses whether the KCC unlawfully departed from its prior decisions by imputing revenue for the Oklahoma Municipal Power Authority (OMPA) contract, the space-heating rate, and the cogeneration (interruptible) deferral contracts.

It appears, however, that whether the imputation of revenue was proper turns on whether it was supported by substantial competent evidence. In *Northwest Cent.*

Pipeline Corp. v. Kansas Corp. Comm'n, 237 Kan. 248, 259, 699 P.2d 1002 (1985), *vacated on other grounds* 475 U.S. 1002, 89 L. Ed. 2d 289, 106 S. Ct. 1169 (1986), the court, following previous Kansas case law, stated, "A regulatory body has authority to change positions on an issue if the new position is supported by substantial, competent evidence." Of course, as stated earlier, the KCC must set forth in its orders the basis for its decision. *Southwest Kan. Royalty Owners Ass'n v. Kansas Corporation Comm'n*, 244 Kan. 157, 165, 769 P.2d 1 (1989). Further, the doctrine of stare decisis is generally inapplicable to administrative agencies. *In re Appeal of K-Mart Corp.*, 238 Kan. 393, 396, 710 P.2d 1304 (1985). It is undisputed that the KCC's order must be lawful, but KG&E does not challenge the KCC's authority to impute revenue in general. The contention is that, by doing so, the KCC unlawfully departed from prior orders. Therefore, KG&E's Issue III will not be directly addressed, but rather will be incorporated into the substantial competent evidence issue as necessary.

To iterate the proper standard of review, unless the KCC's conclusions are "so wide of the mark as to be outside the realm of fair debate," the evidence will be considered substantial and competent to support the determination. *Zinke & Trumbo, Ltd. v. Kansas Corporation Comm'n*, 242 Kan. 470, 474, 749 P.2d 21 (1988). Because of the expertise required in making the determinations necessary in a rate case, the KCC's actions are presumed valid. *Midwest Gas Users Ass'n v. Kansas Corporation Commission*, 3 Kan. App. 2d at 380-81.

KG&E contends the adjustments made to impute revenue and ultimately arrive at a surplus revenue requirement are not supported by substantial competent evidence. We will address each of these adjustments individually.

The first adjustment imputes $5,072,033 in additional revenue to interruptible sales contracts. This amount represents the difference between what is actually col-

lected on the contracts and revenue which would have been received had KG&E sold the electricity at firm service rates. Under these contracts, the flow of electricity to these customers could be interrupted during capacity shortages. The theory behind a reduced rate is that the utility will build a plant having sufficient capacity to meet the peak demand of its regular customers. The regular customers pay for reasonable rate of return on the cost of the plant. At non-peak times, there is a surplus of energy, and the KCC has wisely allowed the sale of that energy at a reduced rate because it does not require the expenditure of funds to build a plant large enough to handle the interruptible load at peak periods. Here, KG&E has a surplus of plant capacity; thus, the interruptible service will not be interrupted. The sales were apparently made to retain the industrial customers, who, otherwise, were pursuing private cogeneration. The KCC, rejecting its own staff's recommendation, accepted CURB's position, stating, "These sales, under the guise of load management, are simply an attempt at load retention necessitated by KG&E's high rates, with the hope that the captive ratepayer will pay the difference between the cost of firm service and interruptible service for these large customers." The KCC further stated as its rationale that the imputation of revenue was necessary because KG&E used these interruptible sales to partially satisfy the 41 MW requirement to include the Ripley retirement revenue impact in this third phase-in increase. The KCC outlined each party's position with citations to the hearing transcript and then explained its rationale for the conclusions it reached.

In the order issued in December 1988, the KCC found the 41 MW peak demand growth or decrease in generating capacity had been reached, allowing the inclusion of the Ripley retirement revenue impact in the third phase-in increase. The KCC did not specify, however, how the increase had been met. The KCC stated, "Testimony of KG&E and Staff indicated that KG&E had exceeded the

41 MW capacity increase required by the Ripley Retirement Order in terms of actual annual peak demand and weather normalized peak demand." Later in the order, the KCC again stated the condition had been met "which required that KG&E show that their peak demand or reduced overall generating capability has grown by 41 MW." In the current order, the KCC states the interruptible load had been used to partially meet the requirement.

KG&E contends this conclusion is erroneous. CURB's witness, Dr. Steven Anderson, testified that KG&E used the interruptible load in figuring recorded and projected peak demand. Testimony from the December 1988 hearing on whether KG&E met the contingency indicates KG&E did include interruptible load in its computations forecasting peak demand. Because the testimony exists regarding how KG&E treats its interruptible load, a conclusion that the load was used to partially meet the 41 MW requirement is not outside the realm of fair debate, even though the KCC did not make such an explicit finding in the December 1988 order.

The next question, then, is whether there is substantial competent evidence to support the imputation of revenue. Neither KG&E's witnesses nor the KCC staff's witnesses supported the imputation of revenue. Dr. Anderson, however, testified at length that such treatment would avoid placing an undue burden on ratepayers, because KG&E's efforts are directed more at load retention than load management. He stated that, since the rates charged for this type of contract are reduced, the cost must be passed on to other ratepayers to make up the difference. The KCC articulated this basis for imputing the revenue. The KCC had the discretion to weigh testimony taken during the hearings and could accept or reject testimony offered by any party, including its own staff. *Union Gas System, Inc. v. Kansas Corporation Commission,* 8 Kan. App. 2d 583, Syl. ¶ 1, 663 P.2d 304, *rev. denied* 233 Kan. 1093 (1983). Thus, there is substantial

competent evidence to impute additional revenue for the interruptible sales contracts.

The second adjustment made by the KCC imputed Wolf Creek costs to 42 MW off-system sale of power to OMPA. This resulted in an imputation of $13.5 million. KG&E sold its cheapest gas-fired generated capacity to OMPA. The KCC stated it recognized it had encouraged KG&E to make off-system sales of power but would not allow KG&E's highest cost capacity rates to be paid by its captive ratepayers. As part of its rationale, the KCC noted that KG&E also used this sale to meet part of the 41 MW condition to include the Ripley retirement impact.

Again, as with the interruptible contracts, the KCC did not make a specific finding that the off-system sales were the basis for meeting the 41 MW requirement. There was testimony, however, that the decrease in generating capacity was at least partially due to sales of off-system power, including the OMPA sale. It is not inconceivable that the KCC could now determine the OMPA sale was a factor in KG&E meeting the Ripley condition.

As with the previous adjustment, the KCC rejected the testimony of both its own staff and KG&E in arriving at its conclusion to impute revenue. It found the testimony of CURB's witness compelling. The witness described the method by which such an imputation should be calculated and why this regulatory treatment is appropriate. The KCC weighed the testimony in favor of CURB's witness. There is substantial competent evidence to support the KCC's conclusions.

The final adjustment contested on appeal is the imputation of revenue to KG&E's space-heating rate to offset projected short-term revenue losses of $3.096 million. The KCC describes this rate as "designed to give KG&E a tool to compete with the natural gas industry by offering special rates to those customers who made the invest-

ment and commitment to using electricity to heat their homes in the winter and help with load management in the summer cooling months during critical peak times and to increase sales during off-peak times." The KCC notes this rate was originally approved by the KCC on the basis that KG&E would not seek to recover the losses associated with it from its other customers. By not adjusting its revenue, however, KG&E would now be shifting the burden of this rate to the ratepayers. The KCC balanced this result against the positions presented by its staff and KG&E. The KCC acknowledged it was not finding the rate unreasonable, but was requiring the loss to continue to be borne by the shareholders.

CURB's witness testified that the imputation should be made to offset the loss expected to occur as a result of the space-heating rate. There was testimony that imputation was necessary to accomplish the result of KG&E bearing the cost of the rate, and also testimony regarding the potential economic effects of the rate over time. There was substantial competent evidence for the KCC to adopt this adjustment.

KG&E argues that the KCC, in prior orders, encouraged KG&E to make interruptible sales and off-system power sales, and to put the space-heating rate into effect. Thus, the adjustments adopted in the present order are a departure from the KCC's prior position and, in fact, KG&E is being punished for doing the very things the KCC encouraged. Without going into a lengthy analysis regarding whether this is indeed true, the KCC clearly sets forth its policy with respect to the continued viability of the Wolf Creek orders. Throughout the Wolf Creek rate orders, the KCC has been committed to balancing the risk-sharing between the shareholders and the ratepayers. The KCC iterates this policy with reference to the present case. Thus, even a departure from prior orders would not be arbitrary, capricious, or unreasonable in view of the KCC's justification.

The test is not whether we believe the KCC's orders are sound business decisions and fair to KG&E. We have studied the record before us and examined the positions taken by the parties and, under our statutory standard of review, do not find error.

Charitable Contributions

The KCC, citing a general policy of allowing "equal sharing of a reasonable level of donations among ratepayers and stockholders," only allowed recovery of one-half of KG&E's charitable donations.

The only testimony in the record regarding the charitable contributions was by Debra Weiss, a certified public accountant employed by the KCC as a Senior Utility Regulatory Auditor and Economist. She stated:

> "In previous dockets, The Commission adopted a general standard which allows the equal sharing of a reasonable level of donations among the ratepayers and stockholders. This objective standard recognizes KG&E's interest in being an active and responsible corporate citizen in the communities it serves and that the goodwill inuring to the Company as a result of its donations benefits the stockholders and ratepayers equally. By making this adjustment, Staff is recommending that this standard be applied in this current docket as well."

This issue is governed by two Kansas cases. In *Southwestern Bell Tel. Co. v. State Corporation Commission,* 192 Kan. 39, 73, 386 P.2d 515 (1963), the court held that charitable contributions should be allowed as a legitimate business expense subject to "strict scrutiny by the Commission as to their reasonableness and propriety." The court recognized that, to maintain standing and goodwill in the community, such expenditures must be allowed. In addition, the court acknowledged that other jurisdictions are split on the issue.

In *Gas Service Co. v. Kansas Corporation Commission*, 8 Kan. App. 2d 545, 550, 662 P.2d 264, *rev. denied* 233 Kan. 1091 (1983), we addressed a KCC policy disallowing recovery of all charitable contributions as a matter of policy. The court stated, "We are aware of the considerable authority existing to support the argument that whether to allow dues and charitable donations as operating expenses is a political issue to be decided by the legislature and not a legal issue." 8 Kan. App. 2d at 551. This court then held that it was bound by *Southwestern Bell* in determining whether, as a matter of policy, the KCC could disallow all contributions. We reversed the KCC's decision because there had been no determination of whether the contributions were reasonable. 8 Kan. App. 2d at 552.

Based on the record before us, the KCC's decision to disallow one-half of the charitable contributions was arbitrary and capricious and not based upon substantial competent evidence. The KCC, apparently in other unidentified dockets, has articulated a general standard of equal sharing of the contributions between the ratepayers and the shareholders. The KCC stated:

> "The policy reflects that the charitable organizations receiving donations serve the utility's Kansas service area; do not promote a political or special interest group; that no part of each recipient's earnings inures to the benefit of any private stockholder or individual; and that each donation is to or for the use of a community chest, association, corporation, foundation, fund, organization, or trust located in and conducting substantially all of its activities in the State of Kansas."

The KCC went on to state that, because shareholders and ratepayers both benefit, requiring them to contribute equally was fair. The only reference to reasonableness in the order was a statement by the KCC that it would be unreasonable to make ratepayers fund 100 percent of

the contributions because KG&E's rates were well above average for Kansas utilities.

In *Gas Service Co.*, the court contemplated a finding by the KCC that the specific donations or contributions are unreasonable. The court states first, "The list of charitable donations and dues paid by Gas Service is such that it would be unreasonable to disallow them in toto, for at least a substantial number of them are reasonable on their face without further evidence as to their reasonableness." 8 Kan. App. 2d at 551. The court further noted that on remand the KCC should state which charities it finds unreasonable and its reasons. 8 Kan. App. 2d at 551.

In the present case, no testimony was introduced as to the reasonableness of KG&E's charitable contributions. The KCC did not make any finding of unreasonableness as to the charities. Rather, the KCC based its decision on a policy that, while it might be supported in terms of fairness, is not in compliance with the standard articulated in *Southwestern Bell* and followed in *Gas Service Co.* In the absence of legislation or regulations codifying the policy followed by the KCC in the present case, the KCC was required to find the charitable contributions unreasonable in order to disallow them as operating expenses. Since we are cited to no such authority, the KCC acted arbitrarily and capriciously. This adjustment to KG&E's rates is reversed.

Supremacy Clause

KG&E contends that, because the wholesale rates for electricity sold by it to OMPA were approved by the Federal Energy Regulatory Commission (FERC), the KCC's imputation of revenue to KG&E from the sale violated the Supremacy Clause of the United States Constitution. KG&E made off-system sales of gas-fired generating capacity to OMPA. This power is less expensive

than Wolf Creek power. CURB argued that, in effect, KG&E was shifting "the burden of its most expensive capacity from the company to its captive ratepayers while selling its least expensive power off system." In addition, CURB maintained KG&E had used the capacity sold to OMPA to help meet the 41 MW condition to add the Ripley impact to the third phase-in increase. The KCC agreed and, as a result, imputed $13.5 million to KG&E's revenue, reflecting Wolf Creek costs for the 41.2 MW capacity sale to OMPA, although KG&E actually only recovered the lesser gas-fired generated rate.

The FERC has exclusive jurisdiction over the wholesale rates for sale of electricity in interstate commerce. 16 U.S.C. § 824 *et seq.* (1988). A line of cases interpreting the Federal Power Act, 16 U.S.C. § 791a *et seq.* (1988), resulted in the development of what is called the "filed rate doctrine." *Montana-Dakota Co. v. Pub. Serv. Co.*, 341 U.S. 246, 95 L. Ed. 2d 912, 71 S. Ct. 692 (1951). In *Montana-Dakota*, the Court held, "[T]he right to a reasonable rate is the right to the rate which the Commission [at that time, the Federal Power Commission, now FERC] files or fixes, and that, except for review of the Commission's orders, the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one." 341 U.S. at 251-52. The doctrine has undergone some expansion and an overview of the cases is necessary to an understanding of the posture of the instant case.

In *Narragansett Elec. Co. v. Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied* 435 U.S. 972 (1978), the court determined the Federal Power Act preempted the Public Utility Commission's authority to investigate interstate prices. 119 R.I. at 569. The Public Utility Commission must treat the interstate rate filed as reflecting reasonable operating expenses. 119 R.I. at 568. The Court, in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 69 L. Ed. 2d 856, 101 S. Ct. 2925 (1981), did not

allow a seller of electricity to charge a higher-than-filed FERC rate pursuant to a contract with the purchaser. 453 U.S. at 581-82. The buyer and seller may contract, but if there is a conflict between the rates, the filed rates govern. 453 U.S. at 582.

KG&E relies heavily on *Nantahala Power & Light v. Thornburg*, 476 U.S. 953, 90 L. Ed. 2d 943, 106 S. Ct. 2349 (1986), for its argument that the KCC's imputation of revenue from the OMPA sale is prohibited by the Supremacy Clause. Nantahala and Tapoco both owned power plants and produced electricity that went into the Tennessee Valley Authority. In return, they received a fixed supply of low-cost entitlement power. Nantahala purchased the remainder of power at a higher rate to serve its retail ratepayers. For the purpose of setting rates, the North Carolina Utilities Commission increased the percentage of Nantahala entitlement power. Nantahala, however, could not actually receive the additional less expensive power, so, in effect, it could not recover the FERC-allowed rates. The Court stated:

> "The filed rate doctrine ensures that sellers of wholesale power governed by FERC can recover the costs incurred by their payment of just and reasonable FERC-set rates. When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate." 476 U.S. at 970.

In other words, Nantahala was a buyer of electricity and the State was prohibited from preventing Nantahala from recovering the FERC-approved rates from its retail ratepayers. By requiring it to figure in a higher percentage of low-cost power than it actually received, Nantahala was prevented from recovering FERC-approved rates.

KG&E also relies upon *Mississippi Power v. Miss. ex rel. Moore*, 487 U.S. 354, 101 L. Ed. 2d 322, 108 S. Ct. 2428 (1988). In that case, a Mississippi subsidiary was required to purchase 33 percent of a nuclear power plant output pursuant to the FERC's determination. The Mississippi Public Service Commission allowed the subsidiary to increase its rates. On appeal, the Mississippi Supreme Court stated the FERC determination did not obligate Mississippi to approve a pass-through of those costs to the consumer without a review of the prudence of the investment. The United States Supreme Court reviewed the filed rate doctrine and set forth the applicable rules: States must treat FERC's mandated payments for plant costs as reasonably incurred for the purpose of setting retail rates. FERC has exclusive authority to determine reasonableness of wholesale rates. This applies not only to rates, but to power allocations that affect wholesale rates. Finally, states cannot bar regulated utilities from passing through to customers the FERC-mandated wholesale rates.

KG&E's reliance upon the filed rate doctrine cases appears misplaced. As explained by the United States Supreme Court, the doctrine ensures that the buyer of the wholesale power is allowed to recover its approved costs from the ratepayer. Any variance by states which affects the wholesale rate is prohibited. In the instant case, KG&E is not the buyer of the wholesale power, but the seller. In *Nantahala* and *Mississippi Power*, the affected utility was the buyer of the wholesale power. The wholesale rates paid by OMPA were not affected and OMPA was not prohibited from recovering the FERC-approved rates. The cases simply do not address the effect of state regulation on the seller of the wholesale power that recovers the FERC-filed rate.

The United States Supreme Court has stated on numerous occasions:

> "In the absence of explicit statutory language signaling an intent to pre-empt, we infer such intent where Congress has legislated comprehensively to occupy an entire field of regulation, leaving no room for the States to supplement federal law [citation omitted], or where the state law at issue conflicts with federal law, either because it is impossible to comply with both [citation omitted], or because the state law stands as an obstacle to the accomplishment and execution of congressional objectives." *Northwest Central Pipeline v. Kan. Corp. Com.*, —— U.S. ——, 103 L. Ed. 2d 509, 527, 109 S. Ct. 1262 (1989).

FERC regulates the sale of wholesale power. The KCC's actions in imputing revenue at Wolf Creek rates does not affect the FERC-filed rates. Since the KCC is not regulating the same activity, it seems there can be no conflict, and the Supremacy Clause does not prohibit the KCC's actions.

Authorized Rate of Return on Equity

The KCC in the past had encouraged consumers to conserve electricity and allowed KG&E to charge a lower energy rate for reduced consumption. The current adjustment, however, marks a departure from past practice and modifies the Conservation Use Rate by eliminating the winter and annual limit for usage and allowing a $.0529 discount for winter consumption above 1,540 kilowatt hours. This is to encourage more consumption, which will, in turn, reduce KG&E's excess capacity associated with Wolf Creek. KG&E argues it will recover substantially less revenue because of more customers becoming eligible for the rate, and it will be collecting at a discounted rate. KG&E's witness, Robert Oakes, testified $5.9 million would need to be recovered from other ratepayers to make up for the shortfall caused by this adjustment. Because there was no provision anywhere else in the challenged orders for KG&E to recover the estimated

shortfall of revenue, KG&E contends the adjustment is unlawful.

The KCC accepted its staff's proposal on this adjustment because the staff forecasted it would lead to greater consumption, which, in turn, may actually increase KG&E's revenue. The KCC stated, "It is in light of KG&E's continuing physical excess capacity situation that this Commission will accept the recommendations of Commission staff regarding this change in the Conservation Use Rate. It is our hope that this rate will encourage the increased and efficient use of that excess capacity, while at the same time bringing additional revenue into the company." The KCC further ordered its staff to monitor any revenue shifts and report to the Commission when there is sufficient data to quantify the results of this adjustment. The KCC recognized that its staff's intent was for KG&E to recover any revenue shortfall that might occur.

The evidence regarding this particular adjustment was reflected in testimony by two witnesses. KG&E's witness estimated the need to recover $5.9 million from other ratepayers to cover the shortfall that would occur. KG&E is of the opinion that not enough study has been devoted to the change to warrant subjecting it to a potential revenue loss. On the other hand, the KCC staff's witness disputes that the change would necessarily result in a revenue loss. Both witnesses explained their position and reasoning in arriving at different conclusions. The KCC had substantial competent evidence on which to base the change in the Conservation Use Rate. It was not established that KG&E will actually experience a revenue shortfall, and the KCC, in addressing that concern, left the door open for KG&E to seek recovery of any loss. The KCC further ordered its staff to inform the Commisison of the status of the change once the data became available. The KCC's order was not unlawful.

Zone of Reasonableness

KG&E argues that the overall effect of the adjustments made by the KCC does not allow it an opportunity to earn a reasonable rate of return on its investment, and, thus, is confiscatory. Specifically, KG&E contends the allowed rate of return is 12.03 percent, but its earned rate of return on common equity would drop to 6.89 percent in 1989.

The Kansas Supreme Court summarized the constitutional and legal principles applicable in rate-making decisions in *Kansas Gas & Electric Co. v. Kansas Corporation Comm'n*, 239 Kan. 483, 488-91, 720 P.2d 1063 (1986). The court stated that the goal should be "a rate fixed within the 'zone of reasonableness' after the application of a balancing test in which the interests of all concerned parties are considered." 239 Kan. at 488. According to the court, the parties whose interests must be considered are "(1) The utility's investors vs. the ratepayers; (2) the present ratepayers vs. the future ratepayers; and (3) the public interest." 239 Kan. at 488. The end result of the rate-making decision does not to guarantee the continued financial integrity of the utility. As stated by the court in a prior case, "There is an elusive range of reasonableness in calculating a fair rate of return. A court can only concern itself with the question as to whether a rate is so unreasonably low or so unreasonably high as to be unlawful. The in-between point, where the rate is most fair to the utility and its customers, is a matter for the State Corporation Commission's determination." *Southwestern Bell Tel. Co. v. State Corporation Commission*, 192 Kan. 39, Syl. ¶ 17, 386 P.2d 515 (1963).

Michael York, chief economist for the KCC, testified, recommending a 12.53 percent return on equity. Using the discounted flow model of assessing the proper return on equity, he identified a range of 12.03 to 13.03

percent. On cross-examination, York presented updated calculations using KG&E data obtained closer to the hearing dates. This resulted in a 12.68 percent return on equity, but the staff maintained its recommendation of 12.53 percent. Both the recommended figure and the subsequent figure are well within the identified range of 12.03 to 13.03 percent.

KG&E witness, Earnest Lehman, an assistant director of corporate planning and rates, agreed with the use of the discounted flow model. He disagreed, however, with the figures used by York to arrive at the 12.53 percent return. Rather, Lehman's calculations would yield a recommended return of 13.70 percent, with a range of 12.68 to 14.71 percent. He stated that most comparable utilities are allowed an average rate of return of 12.8 percent, but KG&E should be allowed a higher rate because it is considered a riskier than average electric utility.

Using 1990 projected data, William Avera, a financial and economic consultant and a KG&E rebuttal witness, testified that the $37.2 million decrease in rates proposed by CURB would result in a return on equity of 7.0 percent. This figure, however, has little relevance to the overall result of the order, because only $8.7 million of the increase is being eliminated. Avera's overall assessment of the financial impact of the proposed decrease on KG&E was that it would force KG&E to take extreme financial actions.

In its order, the KCC acknowledged the method used by its staff to calculate the return on equity and also set forth KG&E's concerns. The KCC specifically approved the discounted flow model as used by its staff. The KCC stated:

> "Because of the concern for maintaining an equitable level of risk sharing where KG&E's shareholders and ratepayers are concerned, as well as, past levels of

> return decided by this Commission and the trend in capital costs we are persuaded to adopt the range recommended by staff. We believe a return set within that range will reasonably and adequately compensate KG&E's shareholders. Specifically, we adopt a return on equity at the lower end of the range at 12.03 percent."

The KCC went on to note that it continued its commitment to attempt to balance the burdens and benefits associated with Wolf Creek between the ratepayers and the shareholders.

The KCC's order reflects an acknowledgment of each party's arguments and then a balancing of those interests as required by *Kansas Gas and Electric*, 239 Kan. at 488. The KCC's determination on rate of return is less than requested by KG&E, but is supported by its staff's recommendation. The actual percentage is at the low end of the recommended range, but still within the range. The KCC's determination appears to be within the "zone of reasonableness" and is, therefore, reasonable and lawful. A reasonable rate cannot be confiscatory. *Kansas-Nebraska Natural Gas Co. v. Kansas Corporation Commisison*, 4 Kan. App. 2d 674, 675, 610 P.2d 121, *rev. denied*, 228 Kan. 806 (1980).

Rate Reduction and Tariffs

The industrial intervenors argue that the KCC did not specify how the ordered reduction in rates was to occur, so the orders are not supported by findings of fact based upon substantial competent evidence. At oral argument, all parties agreed that the reduction in rates will be as requested in the industrial intervenors' brief; thus, this issue is moot.

Affirmed in part and reversed in part.

APPENDIX B

Denial of Petition for Review by the Kansas Supreme Court (September 20, 1990)

Court of Appeals Order   District Case No. 142098U

IN THE COURT OF APPEALS
OF THE STATE OF KANSAS

FRANK A. CARO, JR.
1500 S.W. Arrowhead
Topeka, KS 66604

No. 90-64976-A

KANSAS GAS AND ELECTRIC COMPANY,
Applicant,

v

STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS,
Respondent.

(Kansas Corporation Commission Docket No. 142,098-U)

YOU ARE HEREBY NOTIFIED OF THE FOLLOWING ACTION TAKEN IN THE ABOVE ENTITLED CASE:

PETITION FOR REVIEW BY KANSAS GAS AND ELECTRIC COMPANY.
DENIED.

DATE: 09/20/90.

Yours Very truly,
LEWIS C. CARTER
Clerk, Supreme Court

APPENDIX C

Order of the Kansas Corporation Commission
(February 13, 1990)

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

Before Commissioners: Keith R. Henley, Chairman
Rich Kowalewski
Margalee Wright

Docket No. 142,098-U
84-KG&E-197-R

IN THE MATTER OF THE APPLICATION OF KANSAS GAS AND ELECTRIC COMPANY for a determination of the efficiency or prudence of the retirement from service of the Ripley Steam Electric Station and to modify prospectively the September 27, 1985, Order in Docket No. 142,098-U.

ORDER

NOW, the above-captioned matter comes on for consideration and determination by the State Corporation Commission of the State of Kansas (Commission). The Commission, having examined the files and records in this docket and being fully advised in the premises, finds and concludes:

I. INTRODUCTION

1. On November 8, 1984, Kansas Gas & Electric Company (KG&E) filed an application requesting approval of proposed changes in charges for electric service in Docket No. 142,098-U. The application requested an in-

crease in KG&E's rates to cover a forecasted test year revenue deficiency of $373,427,835, principally due to the commercial operation of the Wolf Creek Generating Station (Wolf Creek), of which KG&E owns a 47 percent interest.

2. On September 27, 1985, and November 15, 1985, the Commission, after lengthy technical and public hearings issued orders in this docket. The Commission determined that KG&E's 1985 test year revenue deficiency was $169.6 million and ordered rates be increased to make up the deficiency. The increase in rates was to be phased in over a four-year period, as follows:

Year	Amount (Millions)
1985	$135.0
1986	20.0
1987	14.6
1988	15.6 (5 years to cover deferred phase-in revenues)

3. On March 11, 1987, the Commission issued the Rate Stabilization Plan Order which amended and modified the 1985 Wolf Creek Rate Orders. This order took steps to help KG&E establish sustainable progress toward the restoration of its financial health.

The order allowed KG&E to delay from September 1987 to January 1, 1989, the third increase of $14.6 million previously approved by the Wolf Creek rate order and delayed until 1992 the fourth phased-in rate increase originally scheduled for 1988. The fourth increase, previously approved to be effective for a five year period, was made permanent. The order specifically noted that the Commission was not foreclosing the possibility of further challenge to the third and fourth increases by any customer or the Commission. The order further reaffirmed the Commission's ongoing right to reexamine all elements of KG&E's revenue requirements should it appear that its earnings or rates are unreasonably high.

Additionally, the order provided that the revenue impact from the retirement of the Ripley Steam Electric Generating Station (Ripley) be added to the third increase becoming effective January 1, 1989. Further, the utility was allowed to retain approximately $20 million in annual savings resulting from routine economic refinancing of its debt and preferred stock charges, along with more than $10 million in annual tax savings flowing from the Tax Reform Act of 1986, savings which would normally flow through to ratepayers.

4. On March 19, 1987, the Commission issued an Order in this proceeding, granting KG&E's application for approval of the retirement of the Ripley station. The treatment of the revenue impact resulting from the retirement of Ripley was addressed as a part of the Rate Stabilization Plan Order and was adopted and reaffirmed in the March 19, 1987, order in this proceeding.

As a condition precedent for including the revenue impact of the Ripley retirement with KG&E's January 1, 1989, rate increase, as scheduled under the Rate Stabilization Plan, the Commission directed KG&E to demonstrate that its need for additional generating capacity, whether from peak demand growth or reduced overall generating capability, had increased by 41 Megawatts (MW) from 1986 to 1988.

5. By order issued September 17, 1987, in Docket No. 156,521-U, the Commission approved a plan by KG&E to sell and leaseback the LaCygne Unit No. 2 electric generating facility. The Commission also directed Commission staff to conduct an investigation into all aspects of KG&E's cost of service to determine KG&E's revenue requirement and whether rates existing at that time accurately reflected that revenue requirement. Staff conducted the audit and filed recommendations with the Commission that the Rate Stabilization Plan issued March 11, 1987, be modified.

6. On July 15, 1988, the Commission issued the Rate Modification Order in Docket No. 156,521-U which adopted Commission staff's recommendations. Staff recommended the elimination of the fourth scheduled increase for Wolf Creek set for January 1, 1992, totalling $15.6 million; placing all of Wolf Creek's capacity in rate base at its full prudent value effective December 31, 1988; terminating the accumulation of deferrals at December 31, 1988; amortizing the accumulated deferrals over a 10-year deferral and amortization period; and requiring KG&E to continue a rate moratorium until January 1, 1992.

7. On November 18, 1988, the Commission issued an order setting a hearing and procedural schedule in this docket. The purpose of the hearing, as set out in the order, was to determine whether KG&E had met the condition precedent for including the revenue impact of the Ripley retirement with KG&E's January 1, 1989, rate increase by demonstrating that its need for additional generating capacity, whether from peak demand growth or reduced overall generating capability, had increased by 41 megawatts (MW) from 1986 to 1988. This condition precedent was first established by the Rate Stabilization Order on March 11, 1987, to allow the inclusion of an additional 46 MW of Wolf Creek capacity in rate base to offset the capacity lost from the retirement of Ripley.

8. On December 21, 1988, the Commission conducted a hearing regarding whether KG&E had demonstrated its need for additional generating capacity, in accordance with the condition precedent. Evidence was received which indicated both an increase in peak demand and decrease in system capability.

9. On December 30, 1988, the Commission issued its Order in that proceeding finding KG&E had satisfied the condition precedent that allowed KG&E to include 46 MW of Wolf Creek capacity in rate base as a result of the Ripley retirement.

The Order also allowed KG&E to increase its electric rates by $29 million. The increase included $14.6 million representing the third phased-in rate increase approved in the original Wolf Creek decision and delayed until January 1, 1989, and $14.4 million in revenues associated with the retirement of the Ripley station.

The Commission order also granted a motion by the intervenor Citizens' Utility Ratepayers Board (CURB), to make the $14.4 million Ripley portion of the January 1, 1989, increase interim and subject to refund pending an audit of the company and further hearings to determine whether there is a need for the rate increase associated with Ripley.

The Order directed Commission staff to conduct an audit of KG&E using year end December 31, 1988, financial statements to determine the company's revenue requirement. The Order also expressed the Commission's concern with continuing the sharing of burdens and benefits associated with Wolf Creek between KG&E and its ratepayers. Pending the results of the audit the Commission declared the $14.4 million portion of the January 1, 1989, rate increase as interim and subject to refund.

10. On January 23, 1989, the Commission issued an order denying applications for rehearing by KG&E, and various Industrial Intervenors, including Boeing Military Airplanes, Beech Aircraft Corporation, the Coleman Company, Total Petroleum Company, Inc., LaFarge Corporation and Texaco, Inc.

11. On July 25, 1989, Commission staff informed the Commission of the completion of staff's audit and their findings. Staff recommended that KG&E be allowed to permanently retain the $14.4 million revenue increase that was previously approved on an interim basis, subject to refund and effective January 1, 1989.

The results of staff's audit for the test year ended December 31, 1988, after including the entire January 1, 1989, revenue increase of $29 million, showed KG&E with a revenue deficiency of approximately $18.4 million. The shortfall incorporated the midpoint (12.53 percent) of staff's recommended return on equity range of 12.03 percent to 13.03 percent. Staff also recommended that KG&E's current rate moratorium remain in effect until its scheduled expiration date of January 1, 1992.

12. The Commission set the matter of KG&E's audit and interim rates for public and technical hearings in its order of September 22, 1989. The order also granted a motion by CURB to introduce certain rate design issues into the proceeding pursuant to K.A.R. 82-1-224(b).

13. The Commission conducted public hearings in this matter in Fort Scott, Kansas, on Thursday, November 2, 1989, and in Wichita, Kansas, on Monday, November 20, 1989. Approximately 150 people appeared at the Fort Scott hearing with 42 testifying. Fifteen spoke in favor of the interim rate increase, 21 spoke on behalf of the company as a good corporate ctiizen and praised their employees, and 6 opposed the interim rate increase. In Wichita, approximately 275 people were in attendance with 58 presenting testimony, nearly all of which expressed disapproval of the interim rates and called for a rate reduction.

The Commission conducted formal "technical" hearings in this matter November 1-2, 1989, in Hearing Room B, Fourth Floor, Docking State Office Building, Topeka, Kansas, to hear testimony and arguments regarding KG&E's interim rates and the rate design issues raised by intervenor CURB. The parties and their respective attorneys of record were as follows:

Kansas Gas and Electric, was represented by Gerald R. Deaver, Wichita, Kansas, and Richard D. Gary, Richmond, Virginia.

Industrial Intervenors, Boeing Military Airplanes, Beech Aircraft Corporation, the Coleman Company, Total Petroleum Company, Inc., LaFarge Corporation and Texaco, Inc., were represented by Curtis R. Irby, Wichita, Kansas.

Intervenor, Citizens' Utility Ratepayers Board (CURB) was represented by William G. Riggins, Consumer Counsel, Topeka, Kansas.

Kansas Corporation Commission staff and the public generally were represented by Frank A. Caro, Jr., KCC General Counsel, Topeka, Kansas.

II. JURISDICTION AND NOTICE

14. The Commission finds KG&E is operating as a public utility within the state of Kansas and holds the appropriate certificates of convenience and necessity granted by this Commission authorizing KG&E to transact the business of a public utility in certain areas within Kansas.

15. By Commission order dated September 22, 1989, KG&E was directed to publish notice in newspapers of general circulation in KG&E's service territory at least thirty (30) days prior to the commencement of the formal hearing November 1, 1989, and file proof of publication with the Commission fifteen (15) days prior to the start of the proceedings.

16. On October 13, 1989, KG&E filed proof of publication with the Commission indicating that notice was published as ordered. (Tr. Vol. I, p. 5)

17. The Commission finds notice was reasonable and proper. The Commission concludes, pursuant to K.S.A. 66-101 *et seq.*, it has jurisdiction of all issues raised by the filings, testimony and exhibits of the parties.

III. SUMMARY OF THE EVIDENCE

18. Transcripts of the public and technical hearings were made in this proceeding. The transcript of the November 2, public hearing in Fort Scott, Kansas, consisted of one volume containing 98 pages. The transcript of the November 20, public hearing in Wichita, Kansas, consisted of one volume containing 174 pages. The transcript of the technical hearing consisted of two volumes containing a total of 677 pages.

During the technical hearing, 13 witnesses testified and 10 exhibits were introduced by the parties.

Commission staff presented testimony of the following witnesses:

Robert D. Elliott, Topeka, Kansas, Chief Engineer in the Utilities Division of the Commission.

James M. Proctor, Topeka, Kansas, Chief Utility Regulatory Auditor in the Utilities Division of the Commission.

Shirley K. Sicilian, Topeka, Kansas, Chief of Economic Policy in the Utilities Division of the Commission.

Debra J. Weiss, Topeka, Kansas, Senior Utility Regulatory Auditor and Economist in the Utilities Division of the Commission.

Joe Williams, Topeka, Kansas, Rate Design and Depreciation Analyst in the Utilities Division of the Commission.

Michael T. York, Topeka, Kansas, Chief Economist in the Utilities Division of the Commission.

KG&E, in support of its case, presented testimony of the following witnesses:

William E. Avera, Austin, Texas, principal in Financial Concepts and Applications, Inc. (FINCAP);

George L. Fitzpatrick, Woodbury, New York, President, Applied Energy Group, Inc. (AEG);

James Haines, Wichita, Kansas, Group Vice President, Kansas Gas and Electric Company (KG&E);

Earnest A. Lehman, Wichita, Kansas, Assistant Director for Corporate Planning and Rates, Kansas Gas and Electric Company (KG&E);

Robert F. Oakes, Wichita, Kansas, Manager of Rates, Kansas Gas and Electric Company (KG&E);

Dick F. Rohlfs, Wichita, Kansas, Supervisor of Regulatory Accounting, Kansas Gas and Electric Company (KG&E).

Intervenor, CURB, presented testimony of the following witness:

Steven Andersen, Austin, Texas, principal of Economic & Policy Analysis, Inc.

The Industrial Intervenors offered no testimony or witnesses in this matter.

IV. REVENUE REQUIREMENT

A. RECOMMENDATIONS

19. KG&E framed its case based on past orders of this Commission. Those orders, specifically, the March 11, 1987, Rate Stabilization Order; the March 19, 1987, order authorizing the retirement of the Ripley station; and the July 19, 1988, Rate Modification Order, discussed the treatment of the revenue impact created by the retirement of the Ripley station. KG&E urged the Commission to adopt Commission staff's recommendation that the Ripley related increase of January 1, 1989, made interim subject to refund, should be made permanent and recommended a return on equity of 13.70 percent.

KG&E also presented testimony specifically disputing seven of staff's proposed revenue adjustments and advo-

cating an additional adjustment it believed staff should have made.

KG&E further testified that while it did endorse staff's overall recommendation to the Commission, making the interim rate increase permanent, it did not agree with many of the adjustments made by Commission staff, including those on which it did not specifically present testimony. (Tr. Vol. I, pp. 110-111)

20. The results of staff's audit of the financial position of KG&E as of December 31, 1988, revealed a revenue deficiency of $18,408,008. Commission staff made an overall recommendation that the $14.4 mililon Ripley related increase, made interim and subject to refund, be made permanent and the Commission authorize a return on equity of 12.53 percent. Staff witnesses also proposed 37 adjustments to KG&E's rate base, operating income and capital structure. Staff's adjustments would decrease KG&E's Kansas jurisdictional rate base per books by $8,485,498; decrease KG&E's Kansas jurisdictional operating income per books by $2,302,149; and decrease KG&E's Kansas jurisdictional capital structure per books by $4,496,852.

21. Intervenor, CURB, recommended four adjustments totalling $51,292,000 to KG&E's revenue requirements, as determined by Commission staff. The difference between staff's finding of an $18.4 million revenue deficiency and CURB's recommendations would result in a recommended reduction in KG&E's current rates of $32.9 million.

22. The Industrial Intervenors offered no direct testimony in this proceeding, nor did they take a position at the hearings in support of, or opposition to, the recommendations advanced by any of the parties regarding KG&E's revenue requirements.

B. ADJUSTMENTS

23. KG&E proposed one adjustment to capital structure it believes staff should have recommended. That adjustment is as follows:

Adjustment No. 1 to Capital Structure

This adjustment would result in an increase to the equity component of KG&E's capital structure of $50,917,164 million to reflect the required write-off of Wolf Creek rate base disallowances under Statement of Financial Accounting Standards (SFAS) No. 90.

KG&E asserts that such an adjustment is merited because of this Commission's recent decision to allow such an adjustment in Docket No. 150,368-U, involving Kansas City Power and Light (KCPL). (Tr. Vol. I, pp. 115-116)

Staff argued no adjustment should be made because the Commission is not required to handle the SFAS 90 issue in like fashion for KG&E and KCPL. Furthermore, staff argued that this issue has not been finally determined for KCPL and would not be determined until that utility's next rate case.

Staff is correct in stating that a final decision on this issue has not been made for KCPL. KG&E's reliance on the order in Docket No. 150,368-U is misplaced. This Commission finds staff's argument to be persuasive. We agree with staff that this issue should be handled on its own merits.

24. Staff proposed 37 adjustments to KG&E's rate base, operating income and capital structure.

KG&E offered testimony specifically opposing seven of staff's recommended adjustments. Those seven adjustments are as follows:

Adjustment No. 1 to Rate Base

Staff proposed an adjustment to reduce rate base by $704,048 to eliminate the Epic Center Ice Bank System (Ice Bank). (Tr. Vol. I, p. 21) The Ice Bank was installed at the Epic Center by KG&E to retain Epic Center's air conditioning load. The Ice Bank was pur-

chased, installed and is maintained by KG&E. In turn, Epic Center leased the equipment for 15 years at a cost of $26,000 annually. Staff contends that the annual rental fee for the Ice Bank does not adequately offset the cost of service incurred by the utility and that if the system remained in rate base all Kansas jurisdictional customers would be subsidizing the return on the investment. (Tr. Vol. I, p. 21) Furthermore, staff believes that the investment was made primarily for load retention versus load management. Staff also voiced concern that such an agreement should have had prior approval from this Commission before the installation and subsequent inclusion in rate base of this system and agreement. (Tr. Vol. I, p. 50)

KG&E argued that staff had incorrectly characterized its reasons for installing the ice bank system. It asserted the system was installed to reduce the customer's operating cost so as to be competitive with self generation; to investigate the feasibility of this type of system as a means of reducing system peak load during summer months; and to eliminate or delay the future installation of peak generation equipment. (Tr. Vol. I, p. 92) KG&E also urged the Commission to treat the ice bank system from a peak planning perspective rather than as a competitive move. (Tr. Vol. I, p. 93). It stated that it must be allowed to test such new technologies for demand-side planning that promote conservation as well. KG&E also cited the March 11, 1987, Rate Stabilization Plan as encouraging aggressive pursuit of such technology and programs. (Tr. Vol. I, p. 93)

After careful consideration of KG&E's arguments and reasons for installing the ice bank system and staff's arguments as to why it should be removed from rate base, we find staff's arguments to be persuasive and order the elimination of the Epic Center Ice Bank and related costs.

This Commission encourages conservation demand-side planning and innovations which will aid not just one

customer, but all customers. The agreement reached with Epic Center is unreasonable in that it does not sufficiently cover the costs related to the project. KG&E, itself, acknowledges that the Epic Center's annual lease payment does not cover the costs associated with the investment and its maintenance. KG&E, of all the parties involved, should realize the burdens its ratepayers are carrying makes the possible subsidization of another project highly inappropriate, even if the cost per ratepayer is relatively small. In the future, we expect all utilities contemplating such an agreement, whether for competitive or "experimentation" purposes, to obtain approval from this Commission to assure the propriety of such an agreement as it affects all the utility's ratepayers.

Adjustment No. 5 to Income Statement

Staff's Adjustment No. 5 to Income Statement increases other operating revenues by $1,195,055 by including the amortization of the balance of proceeds from the sale of KG&E's ownership in LaCygne Unit No. 2. The unamortized balance of proceeds at December 31, 1988, is reflected as cost-free capital in the staff adjusted capital structure. (Tr. Vol. I, p. 62) Staff presented testimony that the adjustment was necessary and contemplated by order of this Commission, September 17, 1987, in Docket No. 156,521-U. (Tr. Vol. I, p. 62) Staff argues that the adjustment is needed to fully recognize the benefits for the ratepayers from the balance of proceeds in the jurisdictional cost of service.

KG&E's witness on this adjustment testified that staff had accurately included the amortization of the gain and the tax benefits in its cost of service, but he expressed concern that staff had incorrectly included an amortization to revenue in the calculation of the balance of proceeds which he contends was a different methodology from that used by staff in its 1988 audit of KG&E. (Tr. Vol. I, p. 122) KG&E argues that this calculation results in

a "balance of proceeds" approximately $55 million more than the net proceeds of the sale and double counts the benefits from the sale of LaCygne No. 2. (Tr. Vol. I, p. 122)

Having considered staff's proposed adjustment and KG&E's objections the Commission adopts Staff's Adjustment No. 5 to Income Statement in keeping with the September 17, 1987, order in Docket No. 156,521-U, to guarantee that ratepayers receive the amount of benefits from the sale/leaseback arrangement which were promised them.

Adjustment No. 6 to Income Statement

Staff's Adjustment No. 6 to Income Statement increases net operating income by $620,000 due to the Keyman life insurance policies. (Tr. Vol. I, p. 25) The increase proposed by staff would amount to approximately a $1 million decrease in KG&E's revenue deficiency found by staff's audit. Staff proposed the adjustment to include actual revenues generated by policies for the policy year which began June 1, 1988, instead of revenue estimates used in the Rate Stabilization Plan. (Tr. Vol. I, pp. 48-49)

KG&E objects to staff's adjustment on the premise that staff erred in two ways. First, in including all of the revenue from the policies in the cost of service and second, in not using those figures provided for in the estimated income stream for the 38-year period provided for at the time of the Rate Stabilization Plan. (Tr. Vol. I, pp. 114-115)

Upon review of the transcript and the arguments presented by the parties, the Commission adopts staff's adjustment regarding the Keyman insurance policies. We find staff's use of actual policy year revenue data in place of the estimated revenue stream provided in 1987 to be reasonable. The estimated revenue stream provided for in the 1987 Rate Stabilization Plan was just that—

an estimate. If actual revenues are available and are accurate, reliable, and uncontroverted by the evidence, there is no reason to rely on estimates.

In addition, there is no language in the Rate Stabilization Plan indicating that the ratepayers are to share a portion of the annual income streams with the shareholders. To the contrary, KG&E's prepared schedules do show that all monies were contemplated as ratepayer funds until such time $800 million is received by ratepayers.

Adjustment No. 10 to Income Statement

This adjustment eliminates $8,196 in other revenue and $21,683 in depreciation and amortization expense associated with the Epic Center Ice Bank System. (Tr. Vol. I, p. 27) This adjustment corresponds with Staff Adjustment No. 1 to rate base and staff contends it is necessary to synchronize these two component pieces of the cost of service. (Tr. Vol. I, p. 27)

KG&E opposes the adoption of this adjustment based on the reasoning and testimony presented in opposition to Staff Adjustment No. 1 to Rate Base. *Supra.*

The Commission has adopted Staff Adjustment No. 1 to Rate Base and recognizing the need to synchronize the two components adopts this adjustment based on the reasoning set forth in adopting Staff Adjustment No. 1 to Rate Base. *Supra.*

Adjustment No. 18 to Income Statement

Staff's Adjustment No. 18 to Income Statement increases administrative and general expenses by $36,478 to allow the recovery of one-half of KG&E's charitable donations. Staff's witness testified the adjustment is based on a general standard of the Commission which allows the equal sharing of a reasonable level of donations among ratepayers and stockholders. Staff argues this objective standard recognizes KG&E's interest in being an active and responsible corporate citizen in its service territory. (Tr. Vol. I, p. 32)

KG&E objects to staff's adjustment on the grounds that it should be allowed to include a reasonable level of charitable contributions in its cost of service in order for it to be a good corporate citizen in the communities it serves. KG&E also stated in its defense that Kansas courts have supported the inclusion of 100 percent of reasonable charitable contributions in rates. (Tr. Vol. I, p. 114)

Staff premised this adjustment on the Commission's general policy statement on donations. The Commission's policy expresses our intentions and serves as a basis for evaluating charitable contributions and donations, but all final decisions depend upon the facts of the case. This policy recognizes that the benefits to the utility from such expenditures accrue primarily to the shareholders through tax deductions and a better public image for the utility. The policy reflects that the charitable organizations receiving donations serve the utility's Kansas service area; do not promote a political or special interest group; that no part of each recipient's earnings inures to the benefit of any private stockholder or individual; and that each donation is to or for the use of a community chest, association, corporation, foundation, fund, organization, or trust located in and conducting substantially all of its activities in the State of Kansas.

After a review of the Commission's past decisions regarding charitable contributions and the arguments of the parties, we find that there has been, and will continue to be, a general standard to promote an equal sharing of a reasonable level of charitable donations among ratepayers and shareholders for all jurisdictional utilities. Ratepayers benefit as their communities are enhanced by such donations and shareholders benefit as the utility's valuable good will is enhanced by such donations. Therefore, staff's adjustment will be approved. This adjustment should not deter KG&E's efforts to be a good corporate citizen, after all, it must be recognized

that the shareholders, as well as the ratepayers, benefit. Because both shareholders and ratepayers benefit, it is only fair that both should be expected to contribute equally in this effort. Additionally, to require ratepayers to fund 100 percent of such charitable contributions would be unreasonable in light of Applicant's current rates, which are well above the average for all Kansas electric utility rates.

Staff Adjustment No. 20 to Income Statement

This adjustment, proposed by staff, would eliminate $105,983 of the test year Edison Electric Institute (EEI) dues from the cost of service. This amount is approximately 70 percent of the total 1988 dues. (Tr. Vol. I, p. 34) Staff's witness testified the adjustment was based on an audit report of the expenditures of EEI for the 12 months ended December 31, 1987, conducted by the independent accounting firm of Peat Marwick Main & Co., for the National Association of Regulatory Utility Commissioners (NARUC). National Association of Regulatory Utility Commissioners, *Audit Report On The Expenditures Of The Edison Electric Institute*, EEI, Committee On Utility Association Oversight (Nov. 1, 1988). The audit categorized EEI expenses by purpose. Those expenses determined not to be in the interest of ratepayers were tabulated and used in determining the portion of the total dues to exclude. Staff testified that this disallowance is intended to assure that only the costs associated with those EEI activities that benefit ratepayers are actually recovered from ratepayers. Until the next NARUC audit report is issued, staff has determined 72.56 percent of total EEI dues should be eliminated from the cost of service based on the current report. (Tr. Vol. I, p. 34)

KG&E's witness testified that its objections are based on the grounds that the EEI dues are a reasonable cost of doing business and should be fully included in KG&E's cost of service. (Tr. Vol. I, p. 120) KG&E argued that

its membership in EEI provided valuable benefits to it and its employees, as well as the utility's ratepayers. KG&E also indicated that if similar adjustments were made in a full rate case, as opposed to just making rates permanent, it would present detailed testimony to an adjustment such as this one. (Tr. Vol. I, p. 119) KG&E further argued that Commission precedent allowed the full inclusion of its EEI membership costs. KG&E's witness testified that expenses related to EEI membership were included in rates in full in the September 27, 1985, order in this docket, as well as the staff's 1988 audit of KG&E's 1987 cost of service. (Tr. Vol. I, p. 121)

In proposing this adjustment, staff is following its December 7, 1988, policy statement regarding EEI dues. This policy is one we recognize. The policy statement was developed based on the findings of an audit report prepared by independent auditors, for NARUC, detailing the expenditures of EEI for the 12 months ended December 31, 1987, and released November 1, 1988. We consider NARUC to be a reliable source regarding this issue.

KG&E would have this Commission rule that because a particular issue, the EEI dues, was not disputed and the NARUC report not used in the utility's past audits and rate cases, that it cannot be disputed at present or in the future. We disagree. In previous dockets staff did not present testimony supported by NARUC reports, as it has in this proceeding. To limit any party's resources to only those used in the past would be fundamentally unfair and inhibit this Commission's ability to base our decisions on testimony and data which may prove beneficial to both the utility and its ratepayers. Staff's use of the NARUC audit report is both material and relevant to the matter before us.

Furthermore, KG&E has provided no specific evidence to support the inclusion of these expenses in the cost of service. KG&E merely asserts that its membership in

EEI benefits the utility, its employees, and its ratepayers.

The Massachusetts Department of Public Utilities dealt with a similar assertion in a rate case involving the Western Massachusetts Electric Company. It held the bare assertion that membership in the Edison Electric Institute (EEI) provided numerous and substantial benefits to electric ratepayers did not relieve an electric utility of its duty to prove that EEI dues represented a reasonable utility operating expense. The inclusion of the EEI dues was disallowed. *Re Western Massachusetts Electric Co.*, 80 P.U.R.4th 479, 561-62 (1986).

The Commission finds staff's evidence persuasive, and therefore staff's adjustment to eliminate approximately 72.56 percent of KG&E's EEI dues from its cost of service is adopted.

Adjustment No. 3 to Capital Structure

This adjustment concerns the balance of proceeds from the sale of the LaCygne Unit No. 2, which are the subject of Adjustment No. 5 to KG&E's income statement. *Supra.* This adjustment reflects the unamortized balance of proceeds at December 31, 1988, of $33,503,940 as cost-free capital. (Tr. Vol. I, pp. 66-67) Staff testified it is necessary to reflect the unamortized balance of proceeds as cost-free capital to recognize the cost-free nature of the liability to return these funds to the consumers over the life of the LaCygne operating lease. (Tr. Vol. I, p. 67)

KG&E opposes this adjustment based on the arguments it presents in opposition to Adjustment No. 5 to KG&E's income statement. *Supra.*

Based on our prior approval of Adjustment No. 5 to KG&E's income statement and the need to synchronize the adjustments, we adopt Adjustment No. 3 to Capital

Structure for the reasons set out at Adjustment No. 5 to KG&E's income statement. *Supra.*

25. While KG&E specifically opposed seven of staff's proposed adjustments, it did incorporate other adjustments made by staff into its cost of service while maintaining a general opposition to the adjustments. (Tr. Vol. I, pp. 109-111)

Applicant offered no supporting evidence in opposition to these remaining 30 adjustments recommended by staff which are hereby accepted and approved by this Commission and are as follows:

Adjustment No. 2 to Rate Base

This adjustment decreased KG&E's year end level of materials and supplies, and prepayments by $1,221,323 by adjusting to 13 month average balances. (Tr. Vol. I, p. 21) The adjustment was necessary to accurately reflect the average balance expected to be maintained in these two accounts during the period when the current rates will be in effect. (Tr. Vol. I, p. 21)

Adjustment No. 3 to Rate Base

This adjustment decreases the nuclear fuel stock component of working capital by $4,120,134 by adjusting to an 18-month average balance. (Tr. Vol. I, p. 22) KG&E recently moved to an 18-month refueling cycle for Wolf Creek. The adjustment will more accurately reflect the normalized investment anticipated for nuclear fuel than does the 13 month average balance. (Tr. Vol. 1, p. 22)

Adjustment No. 4 to Rate Base

This adjustment decreases the fossil fuel component of the working capital by $638,616 to reflect a 90-day burn level. This burn level is standard and has been adopted by this Commission in previous dockets. (Tr. Vol. I, p. 22)

Adjustment No. 5 to Rate Base

This adjustment reflects an adjusted cash working capital requirement of <$2,413,535> and a pro forma cash working capital of <$2,168,384>. The difference between the pro forma and adjusted level of cash working capital requirement is $245,151 and is an additional increase to working capital. (See Schedules of Appendix A attached.) This adjustment is the result of a lead-lag study conducted by staff to identify the working capital requirements of KG&E. (Tr. Vol. I, p. 59)

Adjustment No. 1 to Income Statement

This adjustment increases KG&E's revenue by $29,034,426 incorporating the January 1, 1989, rate increase. (Tr. Vol. I, p. 22)

Adjustment No. 2 to Income Statement

This adjustment increased other revenue by $1,240,294 to account for the benefits received by customers utilizing the economic development rider. (Tr. Vol. I, p. 23) The adjustment is in keeping with the January 26, 1988, order implementing this rider in which we held the shareholders of KG&E must be responsible for any shortfall in revenue due to the rider.

Adjustment No. 3 to Income Statement

This adjustment increases revenue $927,946 and reflects the effect of the recent approval of a new contract between the Vulcan Materials Company (Vulcan) and KG&E. (Tr. Vol. I, p. 24) This adjusts the test year Vulcan revenues to reflect the level anticipated during the time these rates will be in effect.

Adjustment No. 4 to Income Statement

This adjustment increases depreciation and amortization expense by $9,673,510 to reflect the amortization of deferred phase-in revenues and carrying charges on excess capacity. (Tr. Vol. I, p. 25) The Rate Modifica-

tion Order of July 15, 1988, ordered KG&E to stop deferring revenues and to amortize the total deferrals beginning January 1, 1989. This adjustment fulfills that order and incorporates this amortization, on a net of tax basis, into the December 31, 1988, financial statements. (Tr. Vol. I, pp. 25-26)

Adjustment No. 7 to Income Statement

This adjustment is a reclassification of the $9,556,673 amortization of the book gain from the sale/leaseback of the LaCygne 2 Generating Station from an expense account to a revenue account. (Tr. Vol. I, p. 26) In Docket No. 156,521-U, this Commission ordered that the book gain from this transaction should be included in KG&E's Kansas jurisdictional cost of service. The adjustment has no material effect on the revenue requirement.

Adjustment No. 8 to Income Statement

This adjustment normalizes KG&E's actual operating revenue and production expense during the test year for abnormal weather. It decreases operating revenues $3,474,256 and production expense $870,503. The effect is a decrease to normalized test year margins of $2,603,753. (Tr. Vol. I, p. 64) This adjustment was made on the basis that weather conditions from the test year varied significantly from the norm. Based on the difference between the test year's degree hour information and the normal degree hour information, it was shown by staff that the difference had significant effects on some customer classes and therefore, the adjustment is necessary.

Adjustment No. 9 to Income Statement

This adjustment includes the effects of staff's customer annualization in the cost of service. The adjustment increases revenue $427,492 and production expense $176,417. (Tr. Vol. I, p. 26) The adjustment is necessary to reflect the expected revenue stream and produc-

tion expenses of KG&E based upon annualized customer levels. (Tr. Vol. I, p. 26)

Adjustment No. 11 to Income Statement

This adjustment reduces operation and maintenance expense by $187,176 to reflect the normalization of the Neosho transformer repair costs and the recovery of the majority of those costs from insurance settlements. (Tr. Vol. I, p. 28)

Adjustment No. 12 to Income Statement

This adjustment allocates the 1988 refueling outage costs over an 18-month period instead of over a 12-month cycle and reduces expense by $2,606,174. (Tr. Vol. I, p. 29) Because the refueling cycle for Wolf Creek has been extended, continuation of the recovery of refueling costs over a 12-month period would allow KG&E to recover 1½ times the costs actually incurred. For that reason, an 18-month recovery is appropriate. (Tr. Vol. I, p. 29)

Adjustment No. 13 to Income Statement

This adjustment reduces maintenance expense $270,569 relating to the Wolf Creek O-ring failure and is similar in nature to Staff Adjustment No. 11 in that it anticipates recovery of the failure related costs from insurance settlements. The adjustment allows one-third of the Kansas jurisdictional portion of the net repair costs into the cost of service or $82,901. (Tr. Vol. I, p. 30)

Adjustment No. 14 to Income Statement

This adjustment reduces operating and maintenance expense $21,230 to eliminate the rental costs associated with an air compressor used at the LaCygne Generating Station. (Tr. Vol. I, p. 30) KG&E's portion of these rental costs is being removed from the cost of service because it is non-recurring now that new compressors have been installed and placed in rate base. (Tr. Vol. I, p. 30)

Adjustment No. 15 to Income Statement

This adjustment increases salary expense by $757,918 and allows a total salary expense in the cost of service based on the test year end level of employees and annualization of all 1988 and the January 1, 1989, salary and wage increase. (Tr. Vol. I, pp. 30-31)

Adjustment No. 16 to Income Statement

This adjustment reduces administrative and general expense by $333,874 to reflect a more current level of property insurance costs. (Tr. Vol. I, p. 31) This adjustment recognizes that several of KG&E's policies had significant decreases in premium costs. (Tr. Vol. I, p. 31)

Adjustment No. 17 to Income Statement

This adjustment, like Staff Adjustment No. 16, reduces administrative and general expense for a decrease in insurance premiums. It decreases operating expenses $722,287 to reflect a more current level of liability insurance coverage. (Tr. Vol. 1, p. 31)

Adjustment No. 19 to Income Statement

This adjustment reduces administrative and general expense $364,121 by normalizing or eliminating certain specific outside service expenditures. (Tr. Vol. I, p. 32) The expenses adjusted include those related to the management audit of Wolf Creek and consulting fees paid to Morgan Stanley and Stone and Webster Management Consultants, Inc. (Tr. Vol. I, pp. 32-34)

Adjustment No. 21 to Income Statement

This adjustment allows one year's amortization of $6.4 million of deferred Wolf Creek operating costs into the cost of service. The annual amortization is $1,280,000. (Tr. Vol. I, p. 34) This adjustment is in accordance with the authorization given in the Rate Stabilization Plan of March 11, 1987, for KG&E to amortize over five years a deferred asset representing the allowed cost of operating

Wolf Creek between the commercial service date and the effective date of the Wolf Creek rate orders. This adjustment reclassifies this amortization to the cost of service from the non-operating expense account in which it is recoded in KG&E's ledger. (Tr. Vol. I, p. 35)

Adjustment No. 22 to Income Statement

This adjustment increases depreciation and amortization expense by $530,327, allowing KG&E a full year of depreciation expense on year end rate base. (Tr. Vol. I, p. 35)

Adjustment No. 23 to Income Statement

The adjustment allows the Kansas jurisdictional portion of the PMA adjustment into the cost of service and was authorized under the Rate Stabilization Plan which called for "above the line" amortization of this expense as long as it did not result in an increase in rates, which it does not. It increases depreciation and amortization expense $3,085,948. (Tr. Vol. I, p. 35)

Adjustment No. 24 to Income Statement

This adjustment increases depreciation expense $90,070. It eliminates certain miscellaneous corrections to book depreciation pertaining to prior years. (Tr. Vol. I, p. 36) The Commission agrees with staff that it is not approprite to include such adjustments in the test year. The effect of this adjustment when combined with Adjustment No. 22 is to allow into the cost of service one year's depreciation on the plant in service at December 31, 1988. (Tr. Vol. I, p. 36)

Adjustment No. 25 to Income Statement

This adjustment corresponds to Adjustment No. 15 and increases payroll taxes $56,919. The increase in salaries results in additional payroll taxes, subsequently this adjustment allows KG&E to recover all of the taxes associated with the payroll expense included in the operating expenses. (Tr. Vol. I, p. 36)

Adjustment No. 26 to Income Statement

This adjustment increases taxes other than income taxes by $562,604 and allows KG&E to recover property taxes on the year end rate base. (Tr. Vol. I, p. 36)

Adjustment No. 27 to Income Statement

This adjustment increases the test year regulatory expenses $31,574 to include costs incurred in regard to this docket, 142,098-U, and Docket No. 164,211-U. It also eliminates the annual amortization of $41,862 associated with Docket No. 84-KG&E-197-R, whose amortization period expired in 1988. (Tr. Vol. I, p. 37)

Adjustment No. 28 to Income Statement

This adjustment allows a two (2) percent return on KG&E's conservation plant and decreases operating income by $27,834. (Tr. Vol. I, p. 37) This adjustment is made pursuant to K.S.A. 66-117, which authorizes this Commission to allow up to an additional two (2) percent return on conservation related plant in service over the return determined for the utility's other plant. (Tr. Vol. I, p. 38)

Adjustment No. 29 to Income Statement

This adjustment increases income taxes-current $29,-799,112 (Schedules, Appendix A attached) and reflects the current income tax effect of the adjustments to the Income Statement proposed by staff and CURB, and adopted by this order. (Tr. Vol. I, p. 38) Because these adjustments increase KG&E's operating income before income taxes, it is necessary to increase the amount of income taxes KG&E will incur. (Tr. Vol. I, p. 38)

Adjustment No. 1 to Capital Structure

This adjustment eliminates the Kansas jurisdictional portion of a $100 million bond issuance which matured on March 15, 1989. (Tr. Vol. I, p. 38) The Commission adopts this adjustment and staff's position that it would

be inappropriate to include outstanding bond issuances in the capital structure if they are to mature shortly after the end of the test year. If included, the resulting capital structure would inaccurately reflect the capital costs incurred by the utility while the rates are in effect. (Tr. Vol. I, pp. 38-39)

Adjustment No. 2 to Capital Structure

This adjustment increases the amount of long-term debt $60,189,208 for the excess of short-term debt over the construction work in progress (CWIP) balance. (Tr. Vol. I, p. 39) The adjustment is necessary as staff's audit revealed KG&E to be using short-term debt to finance rate base. Staff therefore thought, and this Commission agrees, that it is appropriate to include the excess of short-term debt over the CWIP balance in the capital structure. (Tr. Vol. I, p. 40)

26. Intervenor CURB proposed four adjustments to KG&E's revenue requirement totalling $51,292,000. CURB's recommendations would result in adjustments to the following areas: Interruptible Sales; Off-System Sales; Excess Capacity; and Imputed Residential Revenues. (Tr. Vol. I, pp. 204-209)

CURB Adjustment No. 1 to Interruptible Sales

CURB's proposed adjustment to interruptible sales would impute $9.8 million in additional revenues to three contracts between KG&E, and three of KG&E's Industrial customers: Vulcan, Cargill and Farmland. (Tr. Vol. I, p. 239) That adjustment was later recalculated and resulted in a revised recommended imputation of $5,072,033. (Tr. Vol. I, pp. 291-294) The imputation would be equal to the difference between actual revenues and the revenues that would have been received if these sales took place at KG&E's rates for firm service. (Tr. Vol. I, p. 239)

CURB states that, traditionally, interruptible load is not considered in constructing load forecasts because, by

definition, that load can be interrupted during capacity shortages. (Tr. Vol. I, p. 232) KG&E, however includes interruptible load in its forecasts and does not interrupt customers for capacity related (load management) reasons. (Tr. Vol. I, pp. 233-234; Transcript of December 21, 1988 hearing in this docket, pp. 21-22.) CURB contends that its adjustment is necessary because the interruptible sales contracts were attempts by the company at load retention not load management. (Tr. Vol. I, pp. 235-236) CURB further argues that the interruptible discounts are designed to retain sales that otherwise would be lost due to the high costs and inefficiency of KG&E's current generation mix. If an imputation of lost revenues is not made, the excess costs are paid by captive ratepayers. (Tr. Vol. I, pp. 330, 344)

Finally, CURB argues that the load retained by these discount contracts has been used by KG&E to justify the inclusion of additional Wolf Creek capacity in rate base. (Tr. Vol. I, p. 236) Specifically, CURB argues that the company used an increase in interruptible load to help meet part of the condition precedent for including the revenue impact of the Ripley retirement with KG&E's January 1, 1989, rate increase.

KG&E argues that this Commission should disregard CURB's revenue imputation. KG&E's witness suggests that under Kansas law, there is precedent for spreading the effects of a loss of a large customer among the remaining customers. (Tr. Vol. II, p. 485) KG&E contends the issue should not even be discussed as it has not requested an increase to recover the costs of the partial loss resulting from the special rate contracts. KG&E also states that it will do everything in the future to avoid a rate increase to cover such rates. KG&E contends it is wrong for the utility to be penalized for taking action which it says the Commission, in the past, has found to be in the best interest of its ratepayers and shareholders. Further, KG&E contends its shareholders

would be better off if there had been a complete loss which could have been recovered from its remaining customers. (Tr. Vol. II, p. 485)

Commission staff also presented testimony urging the rejection of CURB's revenue imputation to the special contracts. Staff's witness argued that the imputation would be a constructive capacity disallowance, equivalent to removing from rate base the capacity used to serve these customers and eliminating the associated revenues. (Tr. Vol. I, p. 350) Staff argues that retaining the special contract customers benefits all customers because of the contract customers' continued partial, though reduced, contribution to fixed costs. Staff suggested that KG&E might eliminate the contracts if CURB's adjustment were to be adopted, which could lead to loss of load. (Tr. Vol. I, pp. 352-353)

This Commission recognizes the importance of KG&E's need to retain load on its system in view of its excess capacity situation. This Commission also recognizes that in the past it has encouraged KG&E to aggressively work with its customers, large and small, to retain and manage its load. What this Commission will not recognize is the shifting of the cost burden of discounts granted to retain large industrial users onto the backs of small, captive residential and commercial ratepayers.

Having given due consideration to the argument's on both sides of this adjustment, this Commission finds CURB's arguments compelling and hereby adopts its adjustment to KG&E's interruptible sales. These special contracts are designed to provide lower cost power to the industrial users with the caveat that the service can be interrupted at peak times to ensure sufficient service to KG&E's smaller customers. If the contracts in question were entered into for load management purposes, perhaps a smaller or no imputation would be in order. However, this is not the case. Staff agreed with CURB that the

interruptible discounts, in fact, represented load retention rather than load management efforts. (Tr. Vol. I, p. 363) At the present time, KG&E has a considerable amount of physical excess generating capacity on its system. While these industrial customers are being sold power at the less expensive, interruptible rate, the chances of that service being interrupted, even during peak times, are slim to non-existent. These sales, under the guise of load management, are simply an attempt at load retention necessitated by KG&E's high rates, with the hope that the captive ratepayer will pay the difference between the cost of firm service and interruptible service for these large customers.

We disagree with staff that CURB's adjustment would represent a constructive capacity disallowance. Although there may be some conceptual similarities, the two approaches yield much different results. In fact, CURB's witness discussed an alternative treatment of interruptible discounts that would have constituted a constructive capacity disallowance. That alternative treatment would have resulted in a much higher revenue imputation than CURB's proposed adjustment. (Tr. Vol. I, pp. 237-238)

We find non-convincing the arguments presented which contend that this Commission lacks the authority to impute revenue from these contracts, on the grounds that we originally approved the contracts now in question. It must be clarified for the parties that having approved the contracts does not diminish or remove the jurisdictional authority of this body to reconsider and impute the revenue in question. This issue was specifically addressed in KG&E's recent special contract with Boeing Military Airplanes, which we approved in Docket No. 167,116-U.

Furthermore, the imputation of revenue from these contracts is necessary because KG&E used the load retained through these contracts in partially meeting the condition

precedent for including the revenue impact of the retirement of the Ripley Steam Station with KG&E's January 1, 1989, rate increase. In the December 1988 hearing in this docket, the evidence indicated that KG&E's interruptible load increased from 49 MW in 1986 to 101 MW in 1988. If one subtracts interruptible load from KG&E's peak demand, as is traditionally done, KG&E's load growth between 1986 and 1988 would have been either one or 26 MW, depending on whether actual or weather-normalized peaks are used. Conversely, if interruptible load is included, KG&E's peak demand increased by either 53 MW (actual) or 78 MW (weather-normalized). (Transcript of December 21, 1988 hearing in this docket, pp. 20-23) CURB is correct in noting that the inclusion of interruptible load in peak demand was one of the factors which helped KG&E meet part of the condition precedent established by this Commission for including the revenue impact of the Ripley retirement with KG&E's January 1, 1989, increase.

In this case, we believe it would be inequitable to captive ratepayers and contrary to the public interest to utilize rate discount agreements with large customers as a partial justification for increasing rates for all other customers. An adjustment is necessary and we consider CURB's adjustment to be a reasonable method of sharing the high costs of the Wolf Creek between the company and its captive ratepayers.

The Commission also explicitly rejects KG&E's contention that shareholders would be better off if there had been no special contracts and the load had been lost with the revenue loss spread among remaining customers. While the Commission has permissive authority for spreading the effects of the loss of a large customer among the remaining customers, such a determination would depend on the facts in each case. If the evidence indicates that such a customer leaves the KG&E system

as a result of imprudent management, such a total loss would appropriately be borne entirely by shareholders.

To reiterate, the Commission is imputing revenue to these special contracts primarily on the basis that the contractual rate discounts can not, in reality, be justified on the basis that the service being provided in interruptible and therefore less valuable. Due to KG&E's substantial excess capacity, this "interruptible" service is as valuable as firm service and is being discounted merely to retain the load of customers which are naturally seeking alternative energy sources due to KG&E's high rates.

CURB Adjustment No. 2 to Off-System Sales

This adjustment to KG&E's Off-System Sales, as proposed by CURB, would result in the imputation of Wolf Creek costs to a 41.2 MW capacity sale that KG&E has committed to with the Oklahoma Municipal Power Authority (OMPA). The impact of this adjustment will decrease KG&E's revenue requirement by $13.5 million. (Tr. Vol. I, p. 195)

CURB bases its proposed adjustment on its belief that KG&E is selling gas-fired generating capacity off-system that has lower capital and operating costs than Wolf Creek generating capacity. (Tr. Vol. II, p. 649) CURB points out that approximately $18.8 million in costs would be associated with OMPA sale if it were treated as a direct sale of Wolf Creek base load capacity. (Tr. Vol. II, p. 257) CURB, in its brief, argues that this is not just a case of KG&E making extra money selling surplus power. Instead, CURB asserts it is a case of using the sale to justify the Ripley related $14.4 million rate increase, and the inclusion of more expensive Wolf Creek capacity in rates paid by KG&E's Kansas customers. CURB maintains its adjustment would nullify the company's attempt to shift the burden of its most expensive capacity from the company to its captive ratepayers while selling its least expensive power off system. (CURB Brief, p. 24)

KG&E contends such an adjustment is unnecessary because figures show that OMPA does not need Wolf Creek base load capacity, only intermittent service. (Tr. Vol. II, p. 647) Furthermore, KG&E says OMPA does not receive capacity on a "firm" basis and that KG&E will not guarantee energy delivery to OMPA except when the gas-fired generation plants are available to provide the energy. (Tr. Vol. II, p. 646) Because OMPA only needs energy from the capacity it purchased 14.4 percent of the time, KG&E argues it makes more sense to sell the gas-fired power which has a high operating cost. (Tr. Vol. II, p. 647)

KG&E also expresses concern about what type of precedent such an adjustment will mean for future sales of this type. Especially, if an opportunity for such a sale arose and the utility did not make it. KG&E is concerned it would then be punished in a rate proceeding if some consumer advocate or staff felt the sale should have been made. (Tr. Vol. II, p. 484)

Commission staff, like KG&E, disagrees with the proposed revenue imputation from the off-system sale to OMPA. Staff's witness testified that such an adjustment would penalize KG&E's system planners for trying to respond to a well documented excess capacity condition. (Tr. Vol. I, p. 386) Staff opposed imputing Wolf Creek costs to the sale of non-Wolf Creek capacity.

The proposed adjustment and revenue imputation present a difficult policy issue for this Commission. We recognize that this Commission and its staff have encouraged KG&E to look for off-system sales. We also recognize that at first glance, the adoption of CURB's adjustment would seem difficult to reconcile with past policy of this Commission. However, after careful review and due consideration of the arguments of all parties concerned, we find CURB's case to be compelling and persuasive.

It must be noted that this adjustment, which may be considered novel in terms of this Commission, is being

made because of the novel circumstances in this docket. This is not a simple sale of excess power by one utility to another. It is a case of one utility selling its cheapest and lowest cost capacity to another, while including its highest cost capacity in rates paid by its jurisdictional, captive ratepayers. Even more importantly, this sale was used as justification for including that high-cost capacity in rates and the resulting interim rate increase at issue in this docket. KG&E met part of the condition precedent established by this Commission for including the revenue impact of the Ripley retirement with KG&E's January 1, 1989, rate increase by increasing its capacity sales by 43 MW between 1986 and 1988. Included in those 43 MW is the 41.2 MW of capacity committed for 15 years to OMPA. This capacity sale supported KG&E's position that its overall system generating capability had been reduced sufficiently to justify including the revenue impact of the Ripley retirement with KG&E's January 1, 1989, rate increase. (Transcript of December 21, 1988 hearing in this docket, p. 19)

As already stated, we have encouraged and will continue to encourage KG&E to seek off-system sales, as long as those sales will benefit the company's ratepayers, as well as the company. However, such sales cannot be condoned if their effect is to increase rates for Kansas customers as is the case under the very unique facts presented in this docket. Furthermore, any revenue flowing from such off-system sales in the future will flow directly to the company and its stockholders and will not be reviewed by this Commission apart from an application for a rate increase or rate review.

CURB Adjustment No. 3 to Excess Capacity

As proposed, this adjustment would exclude a return on equity on KG&E's investment in 151 MWs of Wolf Creek capacity and reduce KG&E's revenue requirement by $29.6 million. The capacity would be valued at the full prudent cost of $2,376 per Kw. (Tr. Vol. I, p. 207)

CURB's witness testified that it is necessary to periodically reconsider the question of physical excess capacity in order to reflect changes in demand, generating capability and the economic value of a generating unit over time. CURB cites this Commission's 1985 orders dealing with Wolf Creek, pointing to the orders as signs of uncertainty in a decision not to assign a permanent value to KG&E's investment. (Tr. Vol. I, p. 210)

CURB also asserts that this adjustment is necessary if the Commission is to guarantee its goal of risk sharing. CURB argues that the concept of risk sharing implies that the division of economic burdens between ratepayers and shareholders may be adjusted over time in response to changes in factors such as the expected magnitude and duration of inefficiency, the financial condition of a utility and institutional constraints. (Tr. Vol. I, p. 210)

KG&E argues the proposed excess capacity adjustment is in direct conflict with previous orders of this Commission. It cites the 1987 Rate Stabilization Plan Order and the 1988 Rate Modification Order as precedent. (Tr. Vol. II, pp. 464, 488) KG&E also contends that the adoption of CURB's proposed adjustment would unravel 5 years of progress in dealing with Wolf Creek's excess capacity and would unnecessarily penalize the utility.

In its testimony, Commission staff also urged this Commission to deny the CURB proposal. It is staff's belief that the issue of Wolf Creek's excess capacity has been previously dealt with and resolved in the 1987 Rate Stabilization Order and the subsequent 1988 Rate Stabilization Modification Order which provided for the inclusion of the excess capacity. (Tr. Vol. I, p. 385)

Because of the Commission's previous decision regarding the capacity, staff contends that to make such an adjustment now, presents utility management with the risk of double jeopardy. (Tr. Vol. I, p. 383) Staff's witness stated that traditionally excess capacity adjustment

decisions are made only upon completion of construction and near commercial operation. It is staff's contention that re-visiting this issue at additional times, when no new capacity has been added, is no more than a true-up of previous estimated adjustments and exposes the utility to repetitious adjustments for the same capacity decision. *Id.* at 383.

Staff also argued that the proposed adjustment would only be punitive and would not promote efficiency unless the utility was given the opportunity at the outset of the planning process to be rewarded if it did not exceed a pre-determined reserve margin at the time of commercial operation or any future date. (Tr. Vol. I, p. 383) Staff testified that applications of the used and useful test, to the extent advocated by CURB, have never been used by this Commission, or to the best of their knowledge, any other Commission. (Tr. Vol I, p. 384) Staff's witness said if such an adjustment were to be made in the hopes of promoting efficiency, that it would only have downside effects for the utility. KG&E, staff argues, would be unable to respond to any efficiency signals the adjustment would send, because the capacity is already installed and the company has no significant control over load growth in its service territory. (Tr. Vol. I, pp. 384-385)

Since 1985 this Commission has been grappling with the issues surrounding KG&E's excess capacity at Wolf Creek. We tentatively addressed it in the original 1985 Rate Orders. But it is the March 11, 1987, Rate Stabilization Plan and the July 15, 1988, Rate Modification Plan, in which we set forth our decision regarding the treatment of KG&E's excess capacity. In the Rate Stabilization order we allowed all capacity to be valued at its full and prudent value of $2,376. (March 11, 1987, Rate Stabilization Order, Docket No. 142,098-U, p. 26) Furthermore, we found that KG&E's plan for dealing with the excess capacity met our concerns. As a result we found that KG&E could reduce its excess capacity by

53.8 MW on January 1 of each year through 1992. *Id.* at 24-25.

In the Rate Modification Order we authorized all of the Wolf Creek capacity in rate base at December 31, 1988. There are two areas this Commission needs to be very cautious about revisiting once determinations have been made—capacity and the valuation of that capacity.

It is therefore the opinion of this Commission that the issue of excess capacity should generally not be reviewed except in the context of a full rate hearing when additional evidence could be considered with regard to the "used and required to be used" standard. The Commission also reaffirms its order of July 15, 1988, in Docket No. 156,521-U in which the Commission agreed to place all of Wolf Creek's capacity in rate base at full value effective December 31, 1988. This decision was tied to KG&E's commitment to contine a rate moratorium until January 1, 1992. This Commission will not review the excess capacity and valuation issues so long as KG&E honors its rate moratorium. CURB's Adjustment No. 3 to excess capacity is denied.

CURB Adjustment No. 4 to Imputed Residential Revenues

This adjustment recommends the imputation of $3.096 million to KG&E's revenue to represent the loss of revenue from KG&E's residential space heat rate in order to offset an expected short term revenue loss resulting from the reduction of the winter tail block from 7.14 cents to five cents. (Tr. Vol. I, p. 208) Furthermore, CURB recommends that the Commission order KG&E to file separate cost of service studies for each residential rate code at the time of its next rate case. (Tr. Vol. I, p. 270)

CURB maintains the imputation is necessary as the rate was approved in 1987, with the understanding that the utility and its shareholders would make up any revenue shortfall and not attempt to recover that shortfall

from its ratepayers. (CURB Brief, Dec. 8, 1989, p. 28) CURB recognizes that KG&E has indeed absorbed the revenue shortfall which has occurred to date. But CURB also asserts the position that for this to continue in the face of a rate increase and new revenue requirement the shortfall must be imputed so the revenue loss is not shifted from the shareholder to the ratepayer. *Id.* at 28.

KG&E argues that CURB's proposal should be rejected by this Commission as being flawed. KG&E's witness testified that the space heating rate was proposed by the utility as an opportunity to, over time, increase off peak sales through a competitive rate for space heating. KG&E noted that eligibility for the rate requires the installation of a load control device for use during summer peak and emergency conditions. (Tr. Vol. II, p. 486) KG&E confirmed that it had originally predicted a revenue loss, but has also not proposed a rate increase to cover that loss and is not asking for such an increase as a part of this matter. *Id.* at 486.

In its brief, KG&E also points to the approval of the space heating rate, by this Commission, and the mandate given that such a rate has benefits for all customers in the areas of conservation and load growth management, as support for denying this imputation. (Brief of KG&E, p. 39)

Staff's position regarding the proposed adjustment for the space heating rate is in agreement with KG&E's. Staff argues that when the rate was adopted, the Commission did not impute revenues and did not recognize the certainty of long-term revenue shortfalls from the rate. (Tr. Vol. I, pp. 353-354) Staff also proposes that if this Commission were to find the rate to be unreasonable and to adopt CURB's adjustment, it should allow KG&E the opportunity to eliminate these rates. *Id.* at 354.

This proposed adjustment again raises the perception, as seen by KG&E and Staff, that if adopted, this Com-

mission would be penalizing KG&E for actions approved and encouraged by this body. We disagree. This proposed adjustment reflects a concern on the part of the intervenor, CURB, that any rate increase resulting from this matter would no longer require KG&E's shareholders to bear the burden, but would shift the burden to its remaining ratepayers.

KG&E and Staff are correct in their contention that this rate was encouraged and approved by this Commission for its conservation and load management merits. It was also approved on the premise that any short term revenue shortfalls would be absorbed by the utility. It is a rate which was designed to give KG&E a tool to compete with the natural gas industry by offering special rates to those customers who made the investment and commitment to using electricity to heat their homes in the winter and help with load management in the summer cooling months during critical peak times and to increase sales during off-peak times.

Staff presents the option of, if we find the rate to be unreasonable and adopt CURB's adjustment, allowing KG&E the opportunity to withdraw the tariff for the space heat rate if they wish to avoid the imputation. But, as staff's witness testified, such action could work severe hardships on residential customers who have made capital commitments to electric heat. (Tr. Vol. I, p. 355) In addition, we are making no finding that the rate is unreasonable—only that the rate is still producing a net loss and that KG&E should be required to honor its commitment to absorb that loss. For these reasons, the option presented by staff will not be adopted.

Considering that CURB's reasoning in recommending this adjustment was to prevent the unfair shifting of burdens from shareholders to ratepayers and avoiding subsidization of the space heat rate, and staff's testimony that elimination of the rate will do space heat customers no better, we are compelled to adopt the CURB adjust-

ment to the space heat rate and its recommendation that KG&E be ordered to file separate cost of service studies for each residential rate code at the time of its next rate case.

We are convinced that in the long haul all parties will benefit from this rate and that it is justified. However, the company previously committed to absorbing the loss from this rate. If an adjustment is not made to the company's revenue requirement, that loss will be transferred from the company to its customers. CURB's adjustment is a reasonable method of ensuring that the company, not its customers, will bear this loss as it agreed to do. The adjustment is adopted.

V. RATE OF RETURN

27. Staff, through its witness, recommended a return on equity for KG&E of 12.53 percent. (Tr. Vol. I, p. 85) The recommendation represented the mid-point on Staff's recommended range of 12.03 percent to 13.03 percent. Staff's testimony indicated that a number in this range would adequately compensate investors for the risks inherent in KG&E's electric distribution operation. (Tr. Vol. I, pp. 84-85)

To evaluate the return on equity required by KG&E, Staff used the discounted cash flow (DCF) model. The model is used to arrive at a cost of equity estimate for the utility. (Tr. Vol. I, pp. 73-74) The analysis computes the growth rate and dividend yield to arrive at the equity cost estimate. The estimate is then adjusted for risk, the effect of quarterly compounding, and flotation costs to arrive at the recommended return on equity for KG&E. (Tr. Vol. I, pp. 81-85)

KG&E accepted Staff's use of the DCF model in determining its cost of common equity, but expressed concerns about the historic earnings used to calculate the future earnings growth rate, the estimated future divi-

dends, and volatility associated with the analysis. (Tr. Vol. I, p. 96)

28. KG&E recommended a return on equity of 13.70 percent, 1.17 percent more than that recommended by staff. KG&E testified that a higher rate of return was necessary to reflect actual past earnings which staff did not use, an updated stock price and projections on dividend and earnings growth based on *Value Line* projections using 1987 as the starting point and 1993 as the ending point. (Tr. Vol. I, pp. 98-99)

KG&E urged the adoption of its recommendation arguing that staff's method of implementing the DCF model was too volatile, and its estimate of future dividend growth was too conservative. KG&E stressed that staff was able to produce dramatically different results based on the data points used and different key assumptions. KG&E testified that by using more current projections and changing the time frame of the analysis by a year the earnings growth rate and the projected future stock price can change significantly. (Tr. Vol. I, p. 100)

29. Neither intervenors, CURB nor the Industrial Intervenors, offered any testimony or recommendations as to what KG&E's return on equity should be set at in this proceeding.

30. Staff recommended a range from which it felt this Commission could select a return on equity which would adequately compensate the shareholders of KG&E for their investment in the utility. KG&E, on the other hand, stated in its testimony that it believed it's investors expect a return of about 13.70 percent which it recommended. It made this recommendation on the premise that the financial community considers the utility to be a riskier than average electric utility. (Tr. Vol. I, p. 101)

In its testimony, KG&E did express acceptance of staff's use of the DCF method. It is a method which we,

the Commission, have approved of and used in past rate cases to determine the appropriate level of return on equity for our jurisdictional utilities. It is a method whose use we approve of in this matter. Because of the concern for maintaining an equitable level of risk sharing where KG&E's shareholders and ratepayers are concerned, as well as, past levels of return decided by this Commission and the trend in capital costs we are persuaded to adopt the range recommended by staff. We believe a return set within that range will reasonably and adequately compensate KG&E's shareholders. Specifically, we adopt a return on equity at the lower end of the range at 12.03 percent.

The Commission in adopting the low end of staff's recommended return on equity finds that they have satisfied the criteria established in the *Hope* and *Bluefield* cases. *Bluefield Water Works & Imp. Co. v. Pub. Service Comm. of West Virginia*, 262 U.S. 679 (1923); *Federal Power Comm. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). These two cases establish the criteria for determining a fair rate of return in that it should be high enough: 1) to maintain the financial integrity of the enterprise; 2) to enable the utility to attract the new capital it needs to service the public; and 3) to provide a return on common equity that is commensurate with returns on investments in other enterprises of corresponding risk.

As already stated, we believe this will adequately compensate the utility's shareholders for the risk involved in their investment. We believe that using the low end of staff's range reflects this Commission's continued attempt to balance the burden and benefits of Wolf Creek between ratepayer and shareholder. Especially, in light of the high rates being paid by KG&E customers. Use of the low end of staff's range is a reasonable method of balancing those benefits and burdens.

The Commission also finds that it will not utilize its statutory authority under K.S.A. 66-128(c) to impose a penalty, by reducing the rate of return related directly to KG&E's excess capacity. By this determination, the Commission does not, however, take a position as to whether such a penalty rate of return on excess capacity should be utilized in future rate cases where evidence indicates that substantial physical excess capacity remains.

VI. RATE DESIGN

31. Intervenor CURB, proposed several changes to KG&E's rate design in this proceeding. Commission staff recommended two changes to KG&E's Conservation Rate and changes to the customer charge. The Industrial Intervenors offered no testimony regarding the proposed changes or any further changes to KG&E's rate design.

Those changes proposed to KG&E's rate design are as follows:

A. CUSTOMER SERVICE CHARGE ADJUSTMENT

CURB's witness recommended that KG&E's customer service charge for the residential class be reduced by approximately $2.06, which would result in a reduction of KG&E's annual revenues by approximately $5.328 million. (Tr. Vol. I, p. 264)

CURB based its recommendation on its analysis of the total costs that might reasonably be recovered on a per customer basis and concluded that the residential customer charge should be set within a range of $4.23 to $6.33 per month. (Tr. Vol. I, p. 265) According to the testimony CURB's proposed customer charge would include operating and maintenance expense related to customer accounting, services, meters and a portion of the utility's transformers at the lower end of the range, with the upper end including an allowance for return, depreciation, taxes and insurance costs associated with

customer related plant. CURB also testified that the entire range allows for recovery of administrative and general expenses and uncollectables.

CURB's testimony was critical of the minimum system concept used by KG&E in developing its customer charges. CURB argued such analyses result in an over allocation or even double-allocation, of costs to rate classes that are populated by relatively small customers. This bias results because customers are charged not only for customer-related facilities, but also for the demand they impose on the system, even though the demand can be served partially or totally by minimum system facilities. (Tr. Vol. I, p. 266) The CURB witness said a second problem is that the analysis used by KG&E assumes that all associated costs are customer related. (Tr. Vol. I, pp. 266-267)

KG&E's testimony rejects the arguments put forth by CURB regarding the validity of the minimum system approach used to develop the utility's customer service charge. KG&E's witness testified that the basic objective in selecting a cost allocation methodology to use in developing a customer charge is one which equitably assigns company costs to each rate class, which they believe the system accomplishes. (Tr. Vol. II, pp. 656-657) KG&E also contends that with an underpriced customer charge customers with no usage, such as vacant apartments, will not be bearing their full cost for local facilities. (Tr. Vol. II, p. 659)

KG&E's witness also stated the utility, while maintaining the appropriateness of the minimum system method, "would not contest a reduced customer charge provided the revenue given up is spread to other components of the residential rate." *Id.* at 659.

Commission staff testified that it supported a reduction in KG&E's customer charge to a point somewhere within the range recommended by CURB. (Tr. Vol. II, p. 433)

Staff noted that the CURB proposal utilized a calculation methodology substantially similar to that used by Staff in the past. A methodology which has resulted in the filing of customer charges for other utilities within the range recommended by the CURB witness. (Tr. Vol. II, p. 424) Staff testified that KG&E's current residential customer charge range ($7.91 to $8.22) is the result of the evolution of KG&E's rates since the inclusion of Wolf Creek in the utility's generating mix and the Commission's desire to equitably spread the impact of subsequent rate adjustments. *Id.* at 424.

Staff qualified its support of the CURB proposal by adding that if the Commission were to adopt the proposal to the extent of reducing customer charges in the range proposed, it would be necessary to increase KG&E's energy rate at the same time. (Tr. Vol. II, pp. 425-426)

There is perhaps no portion of one's utility bill which creates more confusion, despair and anger than the customer service charge. The charge is a continuous source of questions directed by ratepayers to this Commission and their respective utilities. There are inevitably questions about its purpose, what costs it covers and how it is calculated that often times cannot be answered to the questioners' satisfaction. KG&E's ratepayers are no exception.

It is very hard for the average ratepayer to comprehend the idea of paying, a total of $90, or more for some, each year in the form of a charge which they are frequently told covers the poles and lines which bring them service. Yet, the ratepayers have seen these same poles and lines in place for what they are sure, has been many years.

Beginning with the 1985 Wolf Creek rate increase, and in each subsequent increase, the customer service charge has been increased by the class percentage increase. This approach has increased the charge during that time from $5.47 to the present $7.91 and $8.22. Although we believe

that approach was a reasonable method to deal with the large rate increases during that time, we agree that the present customer service charge cannot be justified on the basis of cost.

It is the desire of this Commission for the above stated reasons, to move KG&E's customer service charge in the direction recommended by Staff and CURB. We believe by lowering the customer charge it will indeed make it more acceptable to KG&E's ratepayers, will provide ratepayers with more control over their total bill, and at the same time make the charge more cost based. Therefore the Commission will adopt the recommendations of Staff and CURB, and order KG&E to reduce its residential customer service charge to $5.50 and the residential customer-Conservation Use Rate service charge to $5.19. KG&E is also directed to increase it's energy charge by $.0017/kwh. Tariffs reflecting the new customer service charge and increased energy rate should be filed within 30 (thirty) days of the date of this order.

B. CONSERVATION USE RATE

Commission Staff recommended in their testimony that the Commission consider elimination of the annual and winter consumption limits for KG&E's Conservation Use Rate, along with the addition of a $.0529 tail block for winter consumption above 1,540 kwh by conservation rate customers. (Tr. Vol. I, p. 356)

Staff testified that in adopting this recommendation the Commission would be setting winter rates closer to marginal off-peak costs and encouraging optimal use of seasonal excess capacity while increasing contributions to fixed costs for the benefit of all KG&E's ratepayers. *Id.* at 356. Staff's witness stated that the intent behind the recommendation is the same as KG&E's space heating rate in that the reduction will cause an increase in consumption and may actually lead to an increase in overall

revenues. Staff's proposal includes the recommendation that if revenue shortfalls do occur, KG&E should be allowed to recover them, possibly through the use of an inclining block for summer residential service usage. (Tr. Vol. I, p. 357)

KG&E in its testimony argued that the expansion of the conservation rate proposed by staff would result in more than $5.9 million that would need to be recovered annually from residential ratepayers not qualifying for the rate. (Tr. Vol. II, p. 665) KG&E's witness stated that while the utility is opposed to staff's proposal it would be willing to eliminate the inverted structure of the summer rate, making the charge for summer and winter usage equal. KG&E's witness stated that this charge would have a negligible effect on revenue. (Tr. Vol. II, p. 667)

Furthermore, KG&E contends that by not conducting an elasticity analysis, staff is presenting the Commission one end of the spectrum. KG&E specifically points to staff projections of a revenue shortfall made up entirely through increased consumption or so much made up that it alleges resulting summer increases have negligible elasticity effect. (Tr. Vol. II, p. 670) It is KG&E's position that the Commission should reject staff's recommendation because no empirical evidence has been presented which shows how the revenue shortfall will be made up, that elasticity effects have been quantified and that the ultimate impact on nonparticipating customers has not been determined by staff. (Tr. Vol. II, pp. 670-671)

Neither, intervenor CURB or the Industrial Intervenors, presented testimony or made recommendations regarding Staff's proposed changes in KG&E's Conservation Use Rate.

Staff's recommendation to eliminate the winter and annual limit on usage and to tack on a tail block rate for winter usage over 1,540 kwh to some extent would

change the meaning we have traditionally given the Conservation Use Rate. In the past we have urged KG&E's ratepayers who are eligible to take advantage of the rate which rewarded them for conserving electricity by allowing them to benefit from a lower energy charge rate. This recommendation would somewhat reverse that past definition. It would encourage increased winter electricity usage in the hopes of promoting the efficient consumption of KG&E's excess capacity.

KG&E has quite clearly expressed its concerns regarding Staff's proposal and its overriding concern that if adopted the proposal will lead to sizeable revenue shortfalls which will need to be spread among other classes of ratepayers not eligible for the conservation rate. The company's concerns have not gone unnoticed by this Commission.

It is in light of KG&E's continuing physical excess capacity situation that this Commission will accept the recommendations of Commission staff regarding this change in the Conservation Use Rate. It is our hope that this rate will encourage the increased and efficient use of that excess capacity, while at the same time bringing additional revenue into the company.

The Commission fully recognizes that some unquantifiable revenue shortfall may occur as a result of the change in the Conservation Use Rate. We therefore direct staff to monitor any shifts in revenue which may occur because of the changes we are instituting here, and report to the Commission at such time as sufficient data is available to quantify these affects.

We do want to make clear our position that this "Conservation" rate is not designed strictly in the terms of environmental or energy conservation considerations which may become factors for future consideration involving this rate. At the present this rate has become a capacity conservation effort. We certainly do not want

to promote the inefficient and complete use of the excess capacity, thus running the risk of having to look for more capacity in the near future. Our goal for this rate is that it will benefit the utility, its shareholders and capacity planners.

VII. RISK SHARING

32. Throughout this proceeding this Commission has placed an emphasis on achieving an equitable level of risk sharing between KG&E's ratepayers and shareholders. In the numerous orders related to KG&E's investment in Wolf Creek and related rate adjustments, this Commission has consistently committed to an ongoing review of risk sharing in order to move toward a more equitable sharing of the burdens of Wolf Creek between KG&E and its customers. Much about this utility and the circumstances surrounding its investment in Wolf Creek have changed since the original rate orders were issued in 1985. It is our duty to balance the interests of the people of Kansas with the interests of the utilities which serve them.

33. There is an abundance of relevant information for the Commission to consider and weigh in reviewing the broad public policy issue of whether the risks and burdens of Wolf Creek are being equitably shared by KG&E's shareholders and ratepayers. The Commission notes, for instance, that KG&E's stock is now selling at a price approximately equal to its pre-Wolf Creek high of 21 and 3/8 (November 1983). The Commission also notes that KG&E recently raised its quarterly dividend to $.43. The company has publicly stated that this increase is in keeping with its objective to return the annual dividend to its pre-Wolf Creek level of $2.36 per share by December 31, 1993. *Standard and Poor's Creditweek* issue of October 9, 1989, which was introduced into evidence in this docket, states with regard to KG&E and this docket: "Despite the staff's recommendation, the Kansas commis-

sion may roll back a portion of the $29 million rate relief implemented earlier this year. This may delay financial improvement a bit, but offsetting gains are possible if recent strong sales growth continues."

34. While noting the improving financial condition of the company, the Commission also is aware that KG&E ratepayers have the highest electric rates of any investor-owned utility in Kansas. A review of tariffs filed with this Commission reveal that, for an average residence consuming 750 kwh per month, KG&E's electric rate is 29.62 percent above the Kansas average. Further, a comparison of electric rates for KG&E and KCPL, an equal owner of Wolf Creek, reveals that between September 1985 (pre-Wolf Creek) and September 1989, KG&E rates for 750 kwh per month residence increased 34.46 percent (from $54.36 to $73.09) while KCPL rates increased only 3.50 percent (from $55.67 to $57.62).

35. Though the evidentiary record in this docket provides substantial support for each of the specific adjustments made by this order, it must be understood by all parties that this Commission's commitment to an ongoing risk-sharing analysis, as reaffirmed in the numerous KG&E Wolf Creek-related orders, is a major public policy foundation for this order. The facts indicate that KG&E and its shareholders are recovering from the setbacks related to the construction and operation of Wolf Creek. This recovery by the company and its shareholders is positive and in the public interest. KG&E ratepayers have not, however, experienced any such recovery. We believe that this order provides a more equitable sharing of the burdens in the public interest. Risk sharing must continue to be reevaluated as time progresses and conditions change.

IT IS, THEREFORE, BY THE COMMISSION ORDERED THAT:

1. The application of the Kansas Gas & Electric Company, to make permanent the $14.4 million portion, of

a $29 million rate increase, related to the retirement of the Ripley Steam Electric Station and made interim and subject to refund by order of this Commission on December 30, 1988, is granted in part and modified in part by the Commission;

2. KG&E shall reduce its rates prospectively, for all rate classes, by $8,677,386 to reflect adjustments to KG&E's revenue requirement proposed by intervenor, CURB, and adopted by this Commission;

3. KG&E shall institute an across-the-board, annual refund of revenues in the amount of $8,677,386 plus interest, collected from January 1, 1989, until such time as KG&E's new rates become effective;

4. KG&E shall reduce its customer service charges and increase its energy charges to levels proscribed by the Commission in this order;

5. KG&E will file tariffs with this Commission to reflect the adjustments made to its Conservation Use Rate as set out in this order;

6. KG&E will file tariffs within 30 (thirty) days of the date of this order to reflect all adjustments recommended and adopted by this Commission as set forth in this order;

7. KG&E shall comply with other rulings of the Commission all as set forth in this order;

8. A party may file a petition for reconsideration of this order within (15) fifteen days of the service of this order. If this order is mailed, service is complete upon mailing, and three (3) days may be added to the above time limit;

9. The Commission retains jurisdiction of the subject matter and the parties for the purpose of entering such further order or orders as it may deem necessary.

Dated: Feb. 13, 1990

Henley, Chmn. (Dissenting); Kowalewski, Com.; Wright, Com.

JUDITH MCCONNELL
Executive Director

[Order Mailed Feb. 13, 1990]

APPENDIX A

KANSAS GAS AND ELECTRIC COMPANY, INC.
DOCKET NO. 142,098-U
KANSAS JURISDICTIONAL
REVENUE DEFICIENCY

Pro Forma Rate Base	\$1,995,068,725
Rate of Return	7.374160%*
Operating income required	\$147,119,560
Operating Income as Adopted	\$152,456,945
Difference	(\$5,337,385)
Income Tax Factor	0.61509
Pro Forma Operating Revenue Deficiency	(\$8,677,386)

* Includes Commission Ordered Return on Equity of 12.03%.

APPENDIX A

KANSAS GAS AND ELECTRIC COMPANY, INC.
DOCKET NO. 142,098-U
KANSAS JURISDICTIONAL
RATE BASE

Rate Base per Books		$2,003,921,230
Staff Adjustments Accepted by Commission:		
No. 1	EPIC Center Ice Bank System	($704,048)
No. 2	Materials & Supplies Levels	(1,221,323)
No. 3	Nuclear Fuel Stock Level	(4,120,134)
No. 4	Fossil Fuel Level	(638,616)
No. 5	Cash Working Capital	(2,413,535)
	SUBTOTAL	$1,994,823,574
Pro Forma Cash Working Capital Adjustment		245,151
Rate Base as Adopted		$1,995,068,725

APPENDIX A

KANSAS GAS AND ELECTRIC COMPANY, INC.
DOCKET NO. 142,098-U
KANSAS JURISDICTIONAL
OPERATING INCOME

Operating Income per Books	$141,431,295
Staff Adjustments Accepted by Commission:	
No. 1 Increase Granted on 1/1/89	$29,034,426
No. 2 Economic Development Rider	1,240,294
No. 3 Vulcan Contract	927,946
No. 4 Amortization of Deferred Phase-in	(9,673,510)
No. 5 Sale/Leaseback of LaCygne 2	1,195,055
No. 6 Keyman Insurance	620,000
No. 7 Amortization of Book Gain on LaCygne 2	0
No. 8 Weather Normalization	(2,603,753)
No. 9 Customer Annualization	251,075
No. 10 EPIC Center Ice Bank System	13,487
No. 11 Neosho Transformer	187,176
No. 12 18 Month Refueling Cycle	2,606,174
No. 13 Wolf Creek O-ring	270,569
No. 14 Air Compressor Rental	21,230
No. 15 Salary Increases	(757,918)
No. 16 Property Insurance	333,874
No. 17 Liability Insurance	722,287
No. 18 Donations	(36,478)
No. 19 Outside Services	364,121
No. 20 Edison Electric Institute Dues	105,983
No. 21 Wolf Creek Operating Costs	(1,280,000)
No. 22 Depreciation Expense	(530,327)
No. 23 PMA Adjustment	(3,085,948)
No. 24 Depreciation Expense	(90,070)
No. 25 FICA Taxes	(56,919)
No. 26 Property Taxes	(562,604)
No. 27 Regulatory Expenses	(31,574)
No. 28 Conservation Plant	(27,834)
No. 29 Income Taxes	(29,799,112)
Commission Adjustments:	
No. 1 Farmland, Cargill, & Vulcan Revenues	5,072,000
No. 2 OMPA Off-System Sales	13,500,000
No. 3 Residential Space Heating	3,096,000
Operating Income as Adopted	$152,456,945
Revenue Decrease Ordered	(8,677,386)
Decrease in Income Taxes	3,340,001
Pro Forma Operating Income as Adopted	$147,119,560

Docket No. 142,098-U
84-KG&E-197-R

In the MATTER OF THE INVESTIGATION BY THE COMMISSION INTO KANSAS GAS AND ELECTRIC COMPANY'S RATES as Ordered in Docket No. 142,098-U, 84-KG&E-197-R on December 30, 1988

Henley, Chairman, Dissenting

I had hoped that today we would be signing the final order in the Wolf Creek rate case saga for the ratepayers of Kansas Gas and Electric (KG&E). Instead, the majority is lowering consumers' rates in the short term by 1.6 percent. The majority is doing this at a much greater cost to consumers in the future: throwing away KG&E's commitment to a rate moratorium for three more years, causing further rate cases to deal with Wolf Creek and increased capital costs resulting from this decision. I must dissent from the majority's decision. The decision is not well reasoned and not based upon substantial evidence. The order being issued under the signatures of the majority is inconsistent with previous orders signed by those same commissioners. The majority's opinion is based on faulty logic and in my opinion, is very detrimental to the ratepayers of KG&E.

CASE HISTORY

In September 1987, the Commission asked the Staff to conduct an audit of KG&E to determine the reasonableness of the rates that had been established in the March 1987 "Rate Stabilization Order". At the conclusion of the audit, Commission Staff recommended that the fourth and final increase of $15.6 million, scheduled for January 1, 1992, be eliminated. In addition, the Commission Staff recommended other changes that reduced by over $800

million the future cost of Wolf Creek to KG&E customers, costs that had already been approved by previous Commission orders. Finally, the Staff recommended that those changes be made only if KG&E agreed to a rate moratorium that would bar KG&E, absent extraordinary circumstances, from filing a rate case until January 1992. The Commission adopted the Staff's recommendations and issued an order. In December 1988, the Commission decided that it wanted Commission Staff to conduct another audit of KG&E in 1989. Staff completed another audit of KG&E, in an audit that spanned 5 months and required over 3,900 Staff hours. The ostensible purpose of the hearing held in this case is to determine whether $14.4 million in temporary rates approved for KG&E in January 1989 should be made permanent. The Staff cost of service audit of KG&E's 1988 results showed that the company has a revenue deficiency of $18.4 million. The majority finds today that KG&E has a revenue excess of $8.7 million. It is important to note that not a single adjustment was made to the Staff's accounting case by either the Commission or CURB. The majority's finding is not based upon defects in Staff's audit, rather it is based upon adoption of an unreasonably low return on equity and three "revenue imputation" (Wolf Creek economic excess capacity) adjustments proposed by CURB. The majority has repudiated our express regulatory treatment of KG&E since 1985 and failed to honor representations we made to the United States Supreme Court to obtain a dismissal of a KG&E appeal.

Although this proceeding was set for the purpose of reviewing KG&E's 1988 cost of service, it must be considered in the context of our regulation of KG&E since 1984. KG&E applied to the Commission in 1984 for a rate increase, principally to recognize the commercial operation of Wolf Creek. In response, we unanimously issued interim Orders in Docket Nos. 120,924-U and 142,098-U on September 27 and November 15, 1985 (Interim orders).

Out of a concern for rate impact, we established rates in the Interim Orders under which KG&E's revenues were $200 million below its cost of service. The approved increase was $21 million less than had been recommended by Staff. Having stated that the Staff-proposed increase would place KG&E under severe financial stress, we concluded that the lower approved increase would have an even more serious impact on KG&E's financial health. To arrive at that harsh result, for rate making purposes, we made severe adjustments to KG&E's investment in Wolf Creek. We justified these adjustments by finding, *on an interim basis*, that a large part of Wolf Creek's capacity was not presently needed (physical excess) and that the remaining part was too expensive (economic excess).

Our approach in the Interim Orders was one of brinkmanship. To protect KG&E's customers from high rates, we pushed KG&E's rates as low as we believed they could go without bankrupting KG&E or jeopardizing its ability to provide safe and adequate electric service. We tilted the scales heavily toward KG&E's customers and challenged KG&E to figure out how to bring the scales into balance without further rate increases, if possible. We not only recognized the very low probability that KG&E could achieve such a result, but also we explicitly stated our expectation that future increases, beyond those approved in the Interim Orders, would be necessary. Indeed, we even identified the costs which would cause such increases—costs which we believed we could temporarily omit in the Interim Orders, but which we knew eventually would have to be recognized in rates.

Thus, the Interim Orders challenged KG&E to achieve balance without further rate increases. As an incentive to seriously face that challenge, we held KG&E's Wolf Creek rate increase to the lowest possible level. But there are only three ways an enterprise can increase profitability: 1) increase prices, 2) increase sales volume, 3)

reduce costs. We took the first one away. With our encouragement and approval, KG&E took action on the other two. KG&E immediately reduced costs, including cutting its annual stock dividend in half, eliminating 200 jobs, reducing its construction budget, freezing officers' salaries, eliminating management incentives, greatly reducing civic and charitable contributions, curtailing involvement in industry and professional associations, and undertaking extensive refinancings to lower interest costs.

Those cost-cutting measures provided breathing room to find longer term solutions. Our March 12, 1986 Order in Docket No. 149,109-U encouraged KG&E's efforts in this regard. We said: "[KGE] is commended for the effort and encouraged to continue creative and innovative efforts which minimize rate shock, but also improve its financial condition."

The list of "longer term" solutions which KG&E implemented with our encouragement and approval is lengthy: continued cost control; accelerated use of tax credits; recapitalization through economic refinancings, sale and lease back transactions, and repurchase of common stock; purchase of corporate owned life insurance; sales of energy and capacity in the wholesale market (including a 41 MW sale to the Oklahoma Municipal Power Authority); special rate contracts for large industrial customers who had the ability to self-generate and would, otherwise, leave the KG&E system entirely; increased off-peak retail energy sales (including development of a rate to encourage use of off-peak electric energy for space heating); and increasing the cost recovery period for Wolf Creek to 40 years.

On March 11, 1987, we unanimously approved a plan to stabilize KG&E's rates. The order we issued (Rate Order Plan) was the permanent Wolf Creek rate order and, as such, superseded the Interim Orders. KG&E's progress in facing the challenge of the Interim Orders

was such that in the Rate Plan Order we were able to end the interim adjustments for physical and economic excess capacity and were able to *delay* the two remaining increases which had been approved in the Interim Orders. (The Interim Orders provided for rate increases of $135 million immediately, $20 million in September 1986, $14.6 million in September 1987, and a temporary five-year increase of $15.6 million in September 1988.)

Most significantly, the Rate Plan Order established a comprehensive rate making plan for KG&E under which the further rate increases, explicitly contemplated in the Interim Orders, could be entirely avoided. For example, the Interim Orders explicitly contemplated further Wolf Creek related increases as the need for Wolf Creek capacity increased and the economics of Wolf Creek, as compared to those of coal generation, improved. In addition, they provided for the accrual of substantial deferred charges for later inclusion in KG&E's cost of service. The Interim Orders also recognized the necessary amortization of the costs which resulted from Wolf Creek's operation after the beginning of commercial service, but prior to the effective date of the rate increase under the Interim Orders. Finally, the Interim Orders provided for a separate evidentiary hearing concerning the retirement of Ripley, thus contemplating a rate increase if that retirement were determined to be prudent.

Prior to the issuance of the Rate Plan Order, on March 11, 1987, the United States Supreme Court noted probable jurisdiction of KG&E's appeal from the Kansas Supreme Court decision which had affirmed the Interim Orders. On the strength of the *permanent* Rate Plan Order and particularly its reversal of the physical and economic excess capacity adjustments made in the Interim Orders, we argued before the United States Supreme Court that the appeal had become moot and should be dismissed. Our motion was granted. Our motion, in pertinent part, stated:

[T]he 1985 Wolf Creek Order was interim in nature . . . a permanent rate proceeding was held and the attached order issued. . . . Thus, KG&E's rates are not based on the 1985 order . . . but rather on order issued by the Commission on March 11, 1987. The recent "permanent" order has results which allow substantial improvements in KG&E's fianances. . . . Furthermore, the March 11th order contains a valuation of the Wolf Creek plant at its full "prudent" original cost rather than the valuation method forming the basis for KG&E's equal protection and due process contentions.

* * * *

The 1985 orders simply have no relevant legal effect on KG&E's current rates, having been superseded in all material respects by the March 11, 1987 order. . . . [It] is the 1985 treatment of Wolf Creek capital costs which is the focus of KG&E's appeal. That treatment, however, is no longer in effect.

* * * *

It may be argued by Appellant that his case is not moot because it represents an issue capable of repetition, yet evading review. . . . In this instance, the specific basis for each of the issues on appeal has been completely changed by the subsequent order making rates permanent. *Furthermore, the March 11, 1987 Commission order contemplates that the framework it established will govern the setting of KG&E's rates for the remaining life of Wolf Creek.* (Emphasis added.)

Today, the majority has failed to honor that commitment to the U.S. Supreme Court.

The majority's position that KG&E's revenues exceed cost of service depends on three revenue imputation adjustments related to special rate concerns, off-system sales, and the residential space heating rate. The major-

ity's position is incorrect, unreasonable and unsupported by either the law or the facts.

IMPUTATION OF CONTRACT REVENUE

The majority imputes $5.072 million of fictional revenues to KG&E based on the differences between the actual revenues KG&E receives from three special contract customers and the revenues which would be received from those customers if they took service under KG&E's standard tariffs.

Under Kansas law, this adjustment is illegal. Kansas cases say the effect of a complete loss of a large customer must be spread to remaining customers. *Gas Service Company v. Kansas Corporation Commission*, 8 Kan. App. 2d 545 (1983). It is not legal or logical to conclude then that a partial loss should meet with a different result. A utility which completely loses a major customer is allowed to recover the entire loss from remaining customers. Is it logical, then, that a utility which reduces a rate to keep a major customer and thereby suffers only a partial loss is punished by a revenue imputation adjustment? Especially in light of the fact that this Commission gave its approval to each of the special contracts in question.

It cannot be argued that KG&E should be required to absorb the loss because rates are unreasonably high. The adjustment for KG&E's imprudence in the construction of Wolf Creek has been made and cannot be made again. The contracts were approved as being reasonable. The permanent rates that were approved in 1987 and 1988 were reasonable, as provided by Kansas law. Kan. Stat. Ann. 66-101 et seq. The rates established in 1987 and 1988 were established *after* each of the three special contracts had been approved by this Commission. How can the Commission provide one regulatory treatment for those contracts in earlier proceedings and then turn 180

degrees without a single fact or law to support its decision?

The majority's revenue imputation is nothing more or less than an economic excess capacity disallowance. The CURB witness, Dr. Andersen, admitted that revenue imputation and capacity disallowance are conceptually equivalent. In fact, the revenue imputation is nothing more than an alternative method of calculating a capacity disallowance. Such a disallowance reinstates the economic excess Wolf Creek capacity adjustment we made in the Interim Orders and then, so we told the United States Supreme Court, permanently abandoned in the Rate Plan Order. The majority, during administrative meeting, agreed that Wolf Creek should be valued at its full prudent cost. Its decision to accept a constructive economic excess capacity adjustment cannot be reconciled with inclusion of Wolf Creek in rate base at full prudent cost.

IMPUTATION OF OFF-SYSTEM SALES REVENUES

The majority also imputes fictional revenues of $13.5 million from KG&E's participation power sale to the Oklahoma Municipal Power Authority (OMPA). CURB argued and the majority has accepted that the OMPA sale should be deemed a direct sale of Wolf Creek capacity, with $13.5 million representing the difference between actual revenues from OMPA and the calculated costs of a direct sale of Wolf Creek capacity. CURB described this adjustment as a reasonable market test of economic viability of Wolf Creek. In other, plainer words, this is an economic excess capacity adjustment for Wolf Creek—one of the very things we told the United States Supreme Court that we never again would do to KG&E's investment in Wolf Creek.

Like the imputation of revenue to special contracts, KG&E is placed in an illogical position by the determination that revenues should be imputed to this off-system

sale. If we assume that KG&E had the foresight concerning the majority's treatment of this sale, KG&E would have rejected the sale and the associated opportunity to gain a contribution to its fixed costs. The concern, then, for KG&E would be that another party would very likely take the position that revenue should be imputed to KG&E for an off-system sale which it could have made, but for some inexplicable reason did not.

The details of the OMPA sale further show the flaws in the majority's determination. OMPA purchased 41.2 MW of KG&E's gas-fired generating stations to meet its intermittent peaking and cycling energy requirements. OMPA did not require the base load capacity represented by Wolf Creek, but rather needed non-base load service, with the higher operating costs but lower capital costs of KG&E's gas-fired generation. The charges to OMPA are fully compensatory and reflect a return on rate base, depreciation, taxes, operating and maintenance expenses, and administrative and general expenses. The charges were also approved by the Federal Energy Regulatory Commission (FERC). Furthermore, and most importantly, the OMPA sale was approved by FERC in July 1986, some eight months before we approved the Rate Plan Order. If a revenue imputation adjustment is appropriate now, it was appropriate then. The Commission did not make a revenue adjustment for the OMPA sale when it made rates permanent in the 1987 Rate Plan Order nor in the 1988 order. The majority's action does not honor the representation made to the U.S. Supreme Court that the Rate Plan Order was the permanent and final rate order regarding the regulatory rate treatment for Wolf Creek.

In the administrative meeting where this case was decided, the majority said that the decision to impute the revenues in this instance was based upon an equity argument that KG&E was using this sale to meet the conditions set out for retirement of the Ripley Steam Electric

Station (Ripley)—to justify the so called 41 MW condition. That is not the case and the imputation must fall. In the Interim Orders, we directed KG&E to file an application regarding the retirement of the Ripley so that we could formally evaluate the prudence of KG&E's retirement of Ripley. We also noted in the Interim Orders that a further increase should be granted if we later determined the retirement to have been prudent. In a separate proceeding in Docket No. 142,098-U, we unanimousily issued an Order on March 19, 1987 (Ripley Order), finding that retirement to have been prudent.

In the Rate Plan Order, we noted the separate proceeding in Docket No. 142,098-U where we had determined that the retirement of Ripley was prudent. Accordingly, as contemplated in the Interim Orders, the Rate Plan Order directed that the revenue impact of retiring Ripley be included with the January 1, 1989 rate increase. This increase was conditioned on KG&E's need for additional generating capacity, from growth in peak demand or reduced overall generating capability, increasing by 41 MWs from 1986 to 1988.

We held a hearing on December 21, 1988, to determine if KG&E had satisfied the 41 MW condition. Our December 30, 1988 Order found that KG&E had satisfied the condition. *The OMPA sale had nothing to do with the 41 MW condition being satisfied.* KG&E's actual peak in 1986 was 1604 MW compared to 1657 MW in 1988, an increase of 53 MW. KG&E's weather normalized peak in 1986 was 1628 MW compared to 1706 MW in 1988, an increase of 78 MW. The OMPA sale was treated as a reduction to system capability, not as a component of peak demand. Consequently, the majority is wrong when it suggests that KG&E used the OMPA sale to satisfy the 41 MW condition. Based on one of the majority commissioner's statements in the administrative meeting that he was also opposed to imputing the revenues of the OMPA sale except for the fact that they used it to meet the

Ripley requirement, this imputation should not be made today.

The sale of power to OMPA reduces KG&E's need for revenue from its Kansas retail residential customers. The OMPA sale produces about $2 million in revenue; the majority penalizes KG&E $13.5 million for having made the sale. The majority is sending the signal that, if the OMPA sale had never occurred, KG&E would be better off. The Commission should be sending signals to KG&E to encourage off-system sales. Last year, such sales produced $8.7 million in savings that reduced KG&E's revenue requirement. The majority effectively says to KG&E that if future off-system sales are made at less than the full cost of Wolf Creek, KG&E's revenue from Kansas customers will be lowered by the difference between the cost of Wolf Creek-supplied power and the sales price of the power. Again, the majority cuts off consumers' noses to spite their faces.

IMPUTATION OF SPACE HEATING RATE REVENUE

Again, the majority imputes $3.09 million of fictional revenues to KG&E to "make up" the revenue loss from reducing the winter tail block in KG&E's residential tariff to 5 cents. The conceptual flaw here is the same as above. KG&E saw an opportunity to increase off-peak sales through a competitive rate for space heating. For the short run, KG&E projected a revenue loss but did not and has not proposed a rate increase to cover that loss. The adjustment ignores the benefits to customers and shareholders which KG&E expects to result over time from a more competitive space heating rate, including the more efficient use of its system, improved system load factors, and an increased load management capability. *These benefits were cited by us in our approval of KG&E's space heating rate in the Rate Plan Order*, which approval was without a revenue imputation. In addition, the competitive pressure placed on residential natural

gas rates by a competitive electric space heating rate can benefit other members of KG&E's residential class.

The majority's characterization of the language of the Rate Plan Order is incorrect. The order provides that short-term revenue loss from provision of the space heating rate would not be passed on to other consumers through higher rates. The Commission stated that in the same order in which the third and fourth increases were made permanent. KG&E has not sought to increase rates beyond the third and fourth increases.

Even if the Commission wanted to adopt an adjustment penalizing KG&E for the "short-term" revenue loss created by its space heating rates, the record does not contain the evidence necessary to make the adjustment contemplated by the March 1987 order. The short-term net revenue loss from the change in the space heating rate should be calculated by the following equation:

Loss (Gain) = (1986 KWh × 1986 Rate) – (1988 KWh x 1988 Rate)

The record of this case does not contain the information necessary to calculate this "adjustment". Mr. Anderson simply calculated the adjustment by using the following equation:

Adjustment = 1986 KWh × 1987 Rate Reduction

Mr. Anderson's adjustment will always show a revenue loss, not just in the short term, because it does not take into account the substantial increase in KWh sales that has occurred because of the reduction in the rate. If the majority is going to support this adjustment before a court of law, it must, at a minimum, balance the alleged loss by the increase in revenues generated by the lowering of the rate.

RATE OF RETURN

Additionally, the majority has "awarded" KG&E an allowed return on equity of 12.03%. There is no evidence in the record to support such an unreasonably low return.

The Staff recommended a return of 12.53%. CURB did not challenge that recommendation. While KG&E contended that its cost of equity is 13.7%, it did not contest the 12.53% recommended by Staff. Even 12.53% is on the low side. Staff witness Michael York conducted an updated analysis at the time he filed his rebuttal testimony. According to Mr. York, over a nine week period the total return increased from 12.53% to 12.68%. The majority said at the administrative meeting that "trends as reported by Regulatory Research Associates are downward." That is incorrect. Regulatory Research Associates, Inc. recently reported that 24 rate decisions from major electric utilities in 1989 have resulted in an average return on equity in those cases at about 13%. ("Focus Notes" December 1, 1989.) Furthermore, the findings made by the majority reintroduce a high level of risk for KG&E's investors—a risk that must be compensated now and later. Staff witness Shirley Sicillian identified this factor when she testified that revenue imputation would require a higher rate of return to compensate KG&E shareholders for an increased risk of under recovery of costs.

CONSERVATION USE RATE

The majority orders that the Conservation Use Rate be made available to 37,500 current residential customers. The impact of the expansion of the Conservation Use Rate is to lower KG&E's revenues by $923,000 million per year. By ordering the expansion of the Conservation Use Rate, the majority reduces KG&E's revenues by at least $923,000 *in addition to* the $8.7 million already ordered. The blue smoke and mirrors employed by the majority to make this possible is language calling for the Staff to evaluate the revenue loss later and report to the Commission. The order states:

> "The Commission fully recognizes that some unquantifiable revenue shortfall may occur as a result

of the change in the Conservation Use Rate. We therefore direct Staff to monitor any shifts in revenue which may occur because of the changes we are instituting here, and report to the Commission at such time as sufficient data is available to quantify these affects (sic)."

Adequate historical experience already exists to calculate the impact of this change in the Conservation Use Rate. Since 1985, when the Conservation Use Rate was created by this Commission, approximately 50 percent of the customers eligible for the rate have signed up for the service. For each customer that takes the service, KG&E loses an average of $127 per customer. The number of customers eligible for the rate will be 14,540. The impact of the change will be $923,000. The reason that the majority is not adjusting revenues to account for the change in the Conservation Use Rate is simple: Much of the rate reduction for residential customers would be used up paying for the Conservation Use Rate. If the Commission accurately reflected the impact of changing the Conservation Use Rate, the small decrease for over three-fourths of KG&E's residential customers would get even smaller.

In order for the change in the Conservation Use Rate tariff to be revenue neutral, electricity usage by the average customer on the tariff would have to *double*, an incredible assumption. It is not a matter of whether rates for other residential customers will have to be increased —the only question is when.

CHARITABLE CONTRIBUTIONS AND DUES

Since the majority did not discuss in administrative meeting the adjustments proposed by KG&E, I can only assume that the majority will address them after it has formulated the rationale for its results. The company's adjustments are numerous and at least deserve the Commission's attention. Among them is the recommendation

of the Staff on charitable contributions and dues. Since these adjustments were not discussed, I can only assume the majority has accepted them. I must dissent from the adjustment to charitable contributions and dues.

CONCLUSION

In conclusion, KG&E started from the Interim Orders with a set of four rate increases that were sufficient to cover a cash return on only 22% of its investment of Wolf Creek. We recognized the financial hardship imposed on KG&E by the Interim Orders, and *we also recognized that the rate levels established therein would increase over time.* Given the difficulties presented by the Interim Orders and our anticipation of future higher rates for KG&E, our primary objective in the regulation of KG&E since 1985 has been to find ways to force KG&E to achieve financial stability within the rate levels established in those orders. In that regard, prior to today, we were succeeding. KG&E's present rates are lower than the levels contemplated in 1985, and more importantly, at least prior to today, no further increases were pending. *Adoption of the Staff's recommendations in this proceeding would have ensured that the moratorium barring KG&E rate increase applications remained in place until 1992.* The majority's Order destroys that prospect.

Even the majority has begun to realize the serious likelihood that KG&E will soon be filing a rate case based upon the results of this decision. In the final draft, a paragraph was added to say that:

> "The Commission also finds that it will not utilize its statutory authority under K.S.A. 66-128(c) to impose a penalty, by reducing the rate of return related directly to KG&E's excess capacity. By this determination, the Commission does not, however, take a position as to whether such a penalty rate of return on excess capacity should be utilized in future

rate cases where evidence indicates that substantial physical excess capacity remains."

Everyone who reads this order must realize that the Commission is imposing a penalty rate of return on KG&E. The majority's order imposes a penalty for interruptible contracts that were approved and in place when the third and fourth rate increases were made permanent. The majority's order imposes a penalty for selling electricity off-system for less than the full cost of production of power from the Wolf Creek plant. The majority's order imposes a penalty for a space heating rate that was approved by the Commission in the same order that made the third and fourth increases permanent. The problem that must be faced by the majority is that it can only count these excess capacity adjustments once.

Regulatory decisions cannot be issued at whim. The Commission's authority is not boundless. The Commission must reconcile its present decisions with prior decisions. The Commission must also meet the procedural due process limitations of the Constitutional restrictions placed on all governments and governmental agencies in the United States.

If the majority thinks it is saving the customers of KG&E money by its decision, it is very short sighted. Another KG&E rate case is imminent, and some of the revenue that we have been able to capture for ratepayers, such as the company life insurance plan which was paid for by stockholders dollars, is at risk. A new test year will contain additional expenses, including substantial rate case and litigation expenses. Decommissioning cost needs to be increased by $1.7 million; the majority wants to put that order out *after* this order is issued. In a new test year, the revenue loss of the changes in the Conservation Use Rate will be undeniably known and determinable. The new test year will also contain the increased costs of the changes in billing and collections ordered by

the Commission. The issue of Return on Equity will be hard fought, not leaving us the ability to rely on fictional trends. KG&E's capital structure will change, as will the value of their stock. All of these factors will allow KG&E to come forward for a rate increase much larger than the 1.6 percent reduction the majority is ordering today. Will the average KG&E residential user of 800 KWh will think that the $1.44 reduction in his monthly bill is worth the larger increases that will be coming? I don't think so.

I voted for the tough order we issued in 1985, cutting KG&E's request by $204 million. In 1987, I voted to delay the third and fourth increases. In 1988, I voted to eliminate the fourth increase and adopt changes that reduced by over $800 million the future cost of Wolf Creek to KG&E customers. I stand foursquare with consumers who want stable rates that will not increase. Today's Order ensures that KG&E's rates will increase. I strongly believe in the broad authority of the Commission to act reasonably to protect consumers and, prior to this Order, I believe the Commission had done that. But Commissions cannot with one order approve or compel actions by a company, only to penalize the company in a later order for taking those action—not without a strong evidentiary foundation, which the majority's Order is lacking.

A brief word about the work of the Commission Staff in this proceeding. The majority has done the Staff and the customers of KG&E an injustice by ignoring Staff's recommendations. During the drafting process, even factual statements outlining Staff's position were deleted from the drafts. The Staff presented a very balanced and fair case to the Commission, which reflects their expertise in the economic, accounting, legal and engineering fields. The Staff's work was exceptional.

Based on all the above reasons, I cannot join the majority's Order and must dissent.

APPENDIX D

Order of the Kansas Corporation Commission Modifying Previous Order and Denying Petitions for Reconsideration (March 21, 1990)

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

Before Commissioners: Keith R. Henley, Chairman
Rich Kowalewski
Margalee Wright

Docket No. 142,098-U
84-KG&E-197-R

IN THE MATTER OF THE APPLICATION OF KANSAS GAS AND ELECTRIC COMPANY for a determination of the efficiency or prudence of the retirement from service of the Ripley Steam Electric Station and to modify prospectively the September 27, 1985, Order in Docket No. 142,098-U.

ORDER MODIFYING PREVIOUS ORDER AND DENYING PETITIONS FOR RECONSIDERATION

NOW, comes for consideration and determination by the State Corporation Commission of the State of Kansas (Commission), the Petitions for Reconsideration filed by Kansas Gas and Electric Company (KG&E), and Beech Aircraft Corporation, Total Petroleum, Inc., Texaco, Inc., LaFarge Corporation and The Coleman Company, Inc.,

(Industrial Intervenors). Having reviewed the petitions, its files and otherwise being fully advised in the premises, the Commission finds as follows:

1. KG&E is a corporation duly organized and existing under the laws of the State of Kansas, and is a public utility within the meaning of K.S.A. 66-104.

2. Industrial Intervenors are corporations duly organized and existing under the laws of the State of Kansas, and are industrial electric service customers of KG&E.

3. On February, 13, 1990, the Commission issued an Order in this docket making permanent in part and modifying a $14.4 million interim rate increase which became effective January 1, 1989. The interim increase is related to the retirement of the Ripley Steam Electric Station. The increase was made interim and subject to refund by order of this Commission on December 30, 1988.

4. The order also directed KG&E to reduce its rates prospectively, for all rate classes, by $8,677,386 to reflect adjustments to KG&E's revenue requirement adopted by this Commission.

5. The order further required KG&E to institute an across-the-board, annual refund of revenues in the amount of $8,677,386 plus interest, collected from January 1, 1989, until such time as KG&E's new rates become effective.

6. KG&E was also ordered to reduce its customer service charges and increase its energy charges to levels proscribed by the Commission. The utility was directed to file tariffs with this Commission to reflect the adjustments made to its Conservation Use Rate as set out in the order, as well as, filing tariffs within thirty (30) days to reflect all adjustments adopted by the Commission and set forth in the order. The order also directed

KG&E to comply with other Commission rulings set forth in the order.

7. On March 5, 1990, Industrial Intervenors timely filed an application for rehearing, pursuant to K.S.A. 66-118b, K.S.A. 77-529 and K.A.R. 82-1-235(c)(2) and (3). Reconsideration was also requested on appropriate and applicable provisions of Kansas law and the Kansas Administrative Regulations and Procedures as are reflected in the Kansas Administrative Procedures Act, K.S.A. 77-501 et seq. Industrial Intervenors contend that the Commission's order is appropriate as it pertains to various accounting issues addressed in the balance of the Commission's order, but contends the order as to the implementation of the rate reduction and rate refund plus interest is vague, subject to various interpretations and is therefore unjust and unreasonable.

8. On March 5, 1990, KG&E timely filed a Petition for Reconsideration, pursuant to K.S.A. 66-118b, K.S.A. 77-529 and K.A.R. 82-1-235(c)(2), (3). KG&E alleges that the Order is unlawful and unreasonable and has enumerated twenty-five (25) specific instances which it believes supports its petition.

9. KG&E is also requesting the Commission stay the effect of the order, or in the alternative modify that portion of the order which directs KG&E to file tariffs within 30 days of the date of the order. The utility is requesting a modification to allow it forty-five (45) days from the date of the Order addressing its petition for rehearing to allow time to seek a stay pending appeal or in the alternative to file tariffs which comply with the order of February 13, 1990, in this docket.

THE COMMISSION FINDS AND CONCLUDES AS FOLLOWS:

1. After giving due and careful consideration to its Order of February 13, 1990, and the contentions raised by the Industrial Intervenors, the Commission finds that

there is no error, and no need for further clarification. Therefore, Industrial Intervenors Petition for Reconsideration on this matter should be denied.

2. Upon careful consideration and study of the contentions raised by KG&E in its petition and a review of this Commission's order of February 13, 1990, the Commission finds and concludes that there is no error, and no need for further clarification of the order. KG&E's petition for rehearing on this matter should be denied.

3. KG&E's petition also requests the Commission to stay the effect of its February 13, 1990, order or in the alternative modify that portion of the order requiring the filing of tariffs to reflect the adjustments adopted in the order to allow forty-five (45) days from the date of this order to allow time for the utility to seek a stay pending appeal.

Pursuant to K.S.A. 1989 Supp. 66-115, the effective date of an order of this Commission is thirty (30) days after the date of service unless or until modified by the Commission.

In light of KG&E's stated, and well known, intentions to seek judicial review of the Order of February 13, 1990, the Commission will deny the request to stay the order, but will grant the request for modification.

IT IS, THEREFORE, BY THE COMMISSION ORDERED:

1. That petitions for reconsideration by Industrial Intervenors and KG&E, of the Commission's Order dated February 13, 1990, should be and is hereby denied.

2. That paragraph 31, at page 55 and paragraph 6, at page 61, should be and are hereby modified to reflect that KG&E has fifteen (15) days from the date of this order, modifying the February 13, 1990 order, to file

tariffs reflecting the adjustments adopted in the Commission's order.

3. The Commission retains jurisdiction of the subject matter and the parties for the purposes of entering such further order or orders as it may deem proper.

Henley, Chmn.; Kowalewski, Com.; Wright, Com. (Dissenting)

Dated: Mar. 21 1990

JUDITH MCCONNELL
Executive Director

[Order Mailed Mar. 22, 1990]

APPENDIX E

Order of the Kansas Corporation Commission
(December 30, 1988)

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

Before Commissioners: Keith R. Henley, Chairman
Rich Kowalewski
Margalee Wright

Docket No. 142,098-U

IN THE MATTER OF THE APPLICATION OF KANSAS GAS & ELECTRIC COMPANY for a Determination of the Efficiency or Prudence in the Retirement from Service of the Ripley Steam Electric Station and to Modify Prospectively the September 27, 1985, Order in Docket No. 142,098-U

ORDER

Now there comes on for consideration and determination by the State Corporation Commission (Commission) of the State of Kansas, the Application of Kansas Gas & Electric (KG&E) for a determination of the efficiency or prudence in the retirement from service of the Ripley Steam Electric Station and replacement of 46 megawatts (MW) of generating capacity, previously provided by Ripley with 46 MW of generating capacity from the Wolf Creek Generating Station.

Background

On March 11, 1987, The Commission issued the Rate Stabilization Plan, which modified the original Wolf Creek Rate Orders issued in 1985. On March 19, 1987, the Commission issued an Order in the above entitled docket, granting the application of (KG&E) for approval of the retirement of the Ripley Steam Electric Generating Station (Ripley), located in Wichita. The treatment of the revenue impact resulting from the retirement of Ripley was addressed as a part of KG&E's Rate Stabilization Plan, approved by the Commission in the Rate Stabilization Plan Order, and such treatment was adopted and reaffirmed in the March 19, 1987, Order in this proceeding. As a condition for including the incremental revenue impact of the Ripley Retirement with KG&E's January 1, 1989, rate increase, as scheduled under the Rate Stabilization Plan, the Commission directed KG&E to demonstrate that its need for additional generating capacity, whether from peak demand growth or reduced overall generating capability, has increased by 41 MW from 1986 to 1988.

On November 18, 1988, the Commission issued an order setting a hearing and procedural schedule in this docket. The purpose of the hearing, according to the order, was to take evidence regarding the issue of whether Kansas Gas and Electric Company's need for additional generating capacity had increased by 41 megawatts from 1986 to 1988, either through peak demand growth or reduced overall generating capability.

On December 6, 1988, Vulcan Materials Company-Chemicals Division filed an Application to Intervene. On December 7, 1988, the Citizens' Utility Ratepayers Board filed a Petition for Leave to Intervene.

On December 21, 1988, the Commission conducted a hearing regarding whether KG&E had demonstrated its need for additional generating capacity, in accordance

with the condition precedent established in the Commission's March 19, 1987 Order.

The following parties entered an appearance in the above-captioned matters: Gerald R. Deaver appeared on behalf of the Applicant, KG&E; Curtis R. Irby appeared on behalf of Boeing Military Airplanes, Beech Aircraft, the Coleman Company, Total Petroleum, Lafarge Corporation, and Texaco, Inc. (hereinafter referred to as the Industrial Intervenors); Milo M. Unruh, Jr. for the intervenor Vulcan Materials Company; Robert V. Eye for the Intervenor Alliance for Liveable Electric Rates (ALERT); William Riggins for the Intervenor Citizens' Utility Ratepayers Board (CURB); and Frank A. Caro, Jr., General Counsel for the Kansas Corporation Commisison Staff and the public generally.

Testimony was presented by the following witnesses: Leslie D. Morgan appeared on behalf of the applicant Kansas Gas & Electric. Robert D. Elliott, Chief Engineer, appeared on behalf of the Commission staff.

Findings of Fact and Conclusions of Law

1. Testimony of KG&E and Staff indicated that KG&E had exceeded the 41 MW capacity increase required by the Ripley Retirement Order in terms of actual annual peak demand and weather normalized peak demand. (Prefiled Testimony of Leslie Morgan at p. 5; Prefiled testimony of Robert D. Elliott at p. 3).

2. At the conclusion of the testimony, Commissioner Kowalewski requested that the parties submit briefs concerning the issue of valuation of the portion of Wolf Creek that would replace the Ripley plant, in the event that the Commission decided that KG&E had met the requisite condition of demonstrating its additional capacity needs. The following parties filed briefs: Commission staff, KG&E, ALERT, CURB, and Industrial Intervenors.

3. The Commission has reviewed the briefs filed in this matter along with its files and previous Orders issued by the Commission relating to the Rate Stabilization Plan, the Ripley Retirement and the Sale/Leaseback of La-Cygne and has determined that the Rate Stabilization Plan Order and its subsequent orders contemplate that the Ripley portion of Wolf Creek be valued consistently with the remainder of Wolf Creek's capacity.

4. The Commission further finds that the portion of the previously approved rate increase scheduled for January 1, 1989, associated with Ripley, reflect the full valuation of Wolf Creek's capacity.

5. On December 12, 1988, the Citizens' Utility Ratepayers Board (CURB) moved the Commission for an Order declaring the $14.4 million portion of the January 1, 1989, rate increase associated with the retirement of the Ripley plant be made interim, subject to refund. As part of its motion, CURB also seeks an investigation of KG&E's rates in order to determine whether there is a need for the rate increase associated with Ripley, and whether there may be matters of cost savings to KG&E that would reduce the increase. KG&E filed a response in opposition to CURB's motion.

6. The Commission finds, after examining CURB's motion and KG&E's response, that the Ripley portion of the previously approved January 1, 1989, rate increase shall be in effect, on an interim basis, and subject to refund.

7. The Commission notes that the Rate Stabilization Plan Order contemplated a review of future scheduled increases. See March 11, 1987 Order, at page 16, "We have not foreclosed the possibility of further challenge to the third and fourth increases."

8. During the past four years the Commission has attempted to achieve equitable solutions to the problems associated with bringing Wolf Creek on-line. This has necessitated a sharing of the burdens and benefits asso-

ciated with Wolf Creek between KG&E and its rate-payers. The Commission is concerned with the risk-sharing aspect of KG&E's rates. In order to determine if the appropriate level of risk-sharing is reflected in rates, especially in light of actions taken by the Company since approval of the Rate Stabilization Plan, the Commission believes an audit of KG&E's rates is necessary.

9. The Commission directs its staff to conduct an audit of KG&E's rates using the Company's 1988 financial data and to have the audit complete by the end of June, 1989, or sooner, so that the Commission may set this matter for hearings soon thereafter.

10. On December 12, 1988, the Industrial Intervenors (Boeing, et al), filed a motion to continue or stay the proceedings because of the pending appeal in Shawnee County District Court Case No. 88-1570. In support of their motion the industrial intervenors cited K.S.A. 77-616. However, subsection (g) of that statute specifically states that this section shall not apply to proceedings under K.S.A. 66-118g through 66-118k and amendments thereto.

11. The Commission finds it does not have jurisdiction to grant this motion and it is therefore dismissed.

IT IS THEREFORE BY THE COMMISSION ORDERED:

1. That KG&E has met the condition established in the March 11, 1987, Rate Stabilization Order, which required that KG&E show that their peak demand or reduced overall generating capability has grown by 41 MW.

2. That the rate increase associated with the inclusion of Ripley capacity in KG&E's rate base shall be made interim subject to refund.

3. That the Commission's staff shall conduct an audit of KG&E's rates using 1988 financial data.

4. That the motions by the Industrial Intervenors be denied.

5. That all motions to Intervene in the proceeding are granted.

6. The Commission retains jurisdiction of the parties and the subject matter for the purpose of entering such further order or orders as it may from time to time deem appropriate.

Dated: December 30, 1988

Henley, Chmn., dissenting in part; Kowalewski, Com.; Wright, Com., dissenting in part.

JUDITH McCONNELL
Executive Director

[Order Mailed Dec. 30, 1988]

THE STATE CORPORATION COMMISSION
OF THE STATER OF KANSAS

Before Commissioners: Keith R. Henley
Rich Kowalewski
Margalee Wright

Docket No. 84-KG&E-197-R 142,098-U

IN THE MATTER OF THE APPLICATION OF KANSAS GAS & ELECTRIC COMPANY for a Determination of the Efficiency or Prudence in the Retirement from Service of the Ripley Steam Electric Station and to Modify Respectively the September 27, 1985, Order.

DISSENT

KEITH R. HENLEY, CHAIRMAN

I respectfully dissent to the portion of this order which makes rates interim. I do not believe that there is any basis to take such action.

/s/ Keith R. Henley
KEITH R. HENLEY
Chairman

December 30, 1988

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

Before Commissioners: Keith R. Henley
Rich Kowalewski
Margalee Wright

Docket No. 84-KG&E-197-R 142,098-U

IN THE MATTER OF THE APPLICATION OF KANSAS GAS & ELECTRIC COMPANY for a Determination of the Efficiency or Prudence in the Retirement from Service of the Ripley Steam Electric Station and to Modify Respectively the September 27, 1985, Order.

DISSENTING IN PART

MARGALEE WRIGHT, COMMISSIONER

I must respectfully dissent in part on the current order regarding Kansas Gas and Electric Company (KG&E). Specifically, I dissent on the valuation of the capacity allowed in rate base for replacement of 46 megawatts (MW) of power from the Ripley Generating Plant. The current dissent must reference the dissent in the LaCygne case Docket No. 156, 521-U (July 15, 1988) for background information. Each point in that dissent must be reiterated and the point to be reemphasized is that the intent of the Rate Stabilization Plan was to allow KG&E language in the order that was legally clear but not specific so that the new FASB guidelines did not require a large write-off by KG&E. I be-

lieve KG&E has moved beyond that agreement in requesting the higher valuation of Ripley.

/s/ Margalee Wright
MARGALEE WRIGHT
Commissioner
December 30, 1988

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

Docket No. 156,521-U

IN THE MATTER OF THE APPLICATION OF KANSAS GAS AND ELECTRIC COMPANY for approval of the sale of its 50% interest in Unit 2 of the LaCygne Generating Station, for a certificate relating to a lease transaction for LaCygne 2, and for recognition of the lease transaction in cost of service.

DISSENT

MARGALEE WRIGHT, COMMISSIONER

I must respectfully dissent on the current order regard KG&E. My dissent focuses on the process followed on this docket, as well as the $6.4 million new rate increase the Commission is approving. Because of the nature of this dissent, I believe it is necessary to lay out some historical framework.

The Wolf Creek rate case order was followed by the Rate Stabilization Plan, which revamped parts of the original Wolf Creek order. The proposal now before the Commission modifies part of the Rate Stabilization Plan. I had grave reservations about the Rate Stabilization Plan, and only signed that order after becoming convinced the Plan would ultimately benefit ratepayers in the long-run, as well as the short-term. Since the present staff proposal is a partial modification of the Rate Stabilization Plan, it is important to revisit the expectations and intent of that Plan.

Rate Stabilization Plan. The Commission had given KG&E a challenge in the Wolf Creek order—to live

within that order and to find creative ways to improve their company's financial standing. The Rate Stabilization Plan that KG&E presented to the Commission was an attempt to do just that. The goal was to stabilize rates as much as possible, to protect the ratepayer from increases and to help the company avoid a hefty and damaging write-off due to mandatory federal accounting changes.

Although I did not agree with some specific elements of the Plan, the overall effects taken together were positive. Staff had done extensive and long-range analysis on their own, requesting such information from the company, and working to adequately analyze how the components would work together. It was only after reviewing these extensive projections that explored the economic assumptions well into the next century that I felt comfortable supporting the Rate Stabilization Plan.

Also, it was only after I was certain that adequate safeguards were written into the order that I signed it. These safeguards included language allowing the Commission to revisit the issues of revaluing the plant and the decision to include all excess capacity.

> The Commission's findings and conclusions in this Order should not be construed as surrendering or limiting the broad authority to review and evaluate the efficiency or prudence of any actions of KG&E, as such authority is granted to it under K.S.A. 66-128, et seq. Nor should this Order be construed as a finding that KG&E's prudent investment in Wolf Creek will not be subject to regulatory review at any time in the future should unexpected contingencies occur in either KG&E's proposed Plan or its operations. (Order, March 11, 1987, pg. 29, para. 46)

Further, I was assured by KG&E's application and the Commission Order that no further rate increases would be allowed under the Plan:

As Mr. Haines testified, ". . . the Plan permits rate recognition by January 1, 1992, of KG&E's prudent investment in Wolf Creek such that, assuming reasonable circumstances, no further rate increases will be needed as the amount of Wolf Creek considered physically excess is reduced or as coal capacity, becomes more expensive." (Haines, TR. 61). Not only does the Plan forestall indefinitely rate increases due to Wolf Creek capital costs, but also delays for a significant time the need for rate increases due to other cost increases. (Order, March 11, 1987, pg. 10, para. 23)

Because of the requested treatment of Wolf Creek capital costs and the requested accounting changes, KG&E's revenue requirements under traditional rate making would theoretically increase in the future. KG&E, however, asserts that any and all such increases would be covered by the income from the insurance policies. (Order, March 11, 1987, pg. 11, para. 25)

LaCygne Sale/Leaseback. The LaCygne Sale/Leaseback was next in the saga of Wolf Creek. I dissented on that order, focusing on the lack of adequate information the Commission had before it to make an informed and careful decision. I believed proper analysis of the effects of our decisions were lacking.

Staff Proposal and Basis for Present Dissent. As a result of the Sale/Leaseback, the Commission determined that an audit should be done of KG&E's current cost of service. The proposal presently before the Commission is staff's proposal stemming from that audit. I have several concerns:

(1) The Rate Stabilization Plan was an intricate balancing of components as well as benefits to ratepayers and shareholders. It is unclear what the effect is of taking several components out of that Plan and changing them.

Careful long-term analysis is essential. The danger in putting all of Wolf Creek's excess capacity in the rate base immediately, and increasing the revenue requirements of the company by the shortened amortization period (at a time when the income from the insurance policies is still minimal) have not been adequately explored. The shorter amortization saves money in the long run, and saves KG&E from an expensive write-off, but there must be adequate assurances that we are not setting up KG&E's ratepayers for a severe rate increase in 1992.

(2) If the Commission is modifying the Rate Stabilization Plan, then I believe it is important to look at the plant's operation and efficiency record. In light of the recent NRC findings of management inefficiency (resulting in a fine), the Commission should have explored the real value of the plant to consumers, and the possibility of a reduced return based on management imprudence.

(3) A related issue was raised during the audit but not pursued. This is in regard to the 100-day shut down of the plant for refueling and subsequent problems and repairs. Increased costs were incurred in that extended shutdown for alternative energy sources. Those increased costs were flowed through automatically to ratepayers on their bills through the energy cost adjustment. The imprudent portion of those costs should be refunded to ratepayers. It is my understanding that initial calculations show KG&E's portion of excess down-time costs at $5 million. This issue needs consideration either during the audit or as a separate matter.

(4) Under the Rate Stabilization Plan, the excess capacity of Wolf Creek was to be phased in over five years. That phase-in would be complete in 1992. In the present order, all excess capacity is being allowed in rate base immediately. However, the most recent load forecasts of the company project actual excess capacity will last until 1995-1998. If we are allowing the company to include all excess capacity in rate base to avoid federal accounting

write-offs, there must be some safeguards protecting ratepayers from significant rate hikes in 1992 based on an artificially-inflated rate base. And, if we allow the company to include all excess capacity in rate base, then a caveat should be that extensive and *meaningful* conservation programs should be implemented by the company immediately, such as company-sponsored weatherization initiatives, commercial/industrial conservation programs in lighting and efficiency techniques, as well as load management equipment installation. The marketing division of KG&E (developed to increase all-electric homes) could be better directed to increase efficiency of end-use of energy.

(5) As much as I may have some doubts about the long-term effect of the majority's decision, there can be no doubts about one element in the order which is clearly incorrect. The order purports to correct a "calculation error" in the original Rate Stabilization Plan. That "correction" increases the January 1, 1989, rate increase from $22.6 million to $29 million. My understanding is that the "calculation error" is claimed to be the inclusion of an additional 46 mw of Wolf Creek capacity due to the retirement of the Ripley plant at a rate base valuation of $1290/kw rather than $2376/kw. Neither the staff report nor the majority decision explains why this was an error in the March 11, 1987, order, and if it was a mistake, why KG&E, staff and other parties failed to point it out previously. The simple fact of the matter is that the valuation of an additional 46 mw of Wolf Creek at $1290/kw was an important part of the carefully and thoroughly considered Rate Stabilization Plan and not an error. Valuation of the additional capacity at $2376/kw is inconsistent with the intent and language of the March, 1987, order. It also sets a dangerous precedent regarding this Commission's treatment of Wolf Creek costs. This Commissioner would certainly not have signed the March 11, 1987, order had that higher valuation been part of the plan to increase rates.

The value of Wolf Creek capacity was, of course, one of the major issues in the extensive proceedings in Docket No. 142,098-U. As a major component of its decision in that case, the Commission found that the reasonable valuation of Wolf Creek was $1290/kw, rather than its higher actual costs. Although the Commission, in the Rate Stabilization Plan, allowed KG&E to reflect a higher value for the plant on its books as of 1992, it was clear that the higher valuation was not expected to actually be reflected in KG&E's rates for service. The same was true of physical excess capacity which the Commission allowed to be phased into rate base over five years. The Rate Stabilization Plan was proposed by the company and approved by the Commission because it offered a means of dealing with Wolf Creek's physical excess capacity and economic inefficiency problems *without* causing rate increases to consumers. A reading of the March 11, 1987, order can lead to no other interpretation. For example, paragraph 43 of that order, on pages 26-27 states:

> KG&E, in its application, requests that we revalue Wolf Creek from our previously determined value of $1290/kw to the full cost of $2376/kw. In the original Wolf Creek rate orders we stated that at the value of $2376, Wolf Creek was an economically inefficient and excessively expensive means of providing electricity to ratepayers. Furthermore, we found that full rate base inclusion of Wolf Creek at $2376/kw would not reflect economic efficiency in that its generating capacity could have been provided at a more reasonable cost to ratepayers. Thus, while we allowed full recovery of the cost of construction of Wolf Creek, (except the prudence adjustment, which is analyzed in paragraph 44) we were determined to share the risk of this excessively expensive plant between shareholders and ratepayers. Therefore, we determined that while the utilities could receive a

return on the value of $1290/kw through rates, the ratepayers could not contribute to the return on the costs over $1290/kw.

Since the determination of $1290 as the value of Wolf Creek resulted from an analysis of the relative cost efficiencies of nuclear and coal plants, we expected to revisit the issue of the value of Wolf Creek and the division of risk for uneconomical plant between ratepayer and shareholder at a later date. In the application before us, KG&E has proposed a method for dealing with the issue of value in a way that deals successfully with our concerns of risk sharing. KG&E proposes to increase the value of Wolf Creek to $2376/kw while at the same time not requiring rate increases beyond what is contemplated in this order. Although there is no firm basis for reassessing the cost efficiency of Wolf Creek, there is a sense in which the value of the plant has increased. Since the KG&E plan contemplates no further rate increases, it could be said the plant is more beneficial to ratepayers. Further a higher valuation will allow KG&E to improve its financial situation. Therefore, to the extent that KG&E can improve its financial situation while holding the line on rate increases, both KG&E and ratepayers benefit from the increase in value of Wolf Creek from $1290/kw to $2376/kw. Of course, if the predicates to the revaluation were to change (i.e., rate stabilization, benefits to ratepayers and shareholders, etc.), the analysis of the Commission could also change. (Order, March 11, 1987, pg. 26-27)

Furthermore, paragraph 47 on page 29 of the Order states:

It must be emphasized that our approval of KG&E's Plan is premised on no rate increases other than those set forth above. This is particularly true of

> the cost of service treatment afforded Wolf Creek costs but includes all the various accounting and ratemaking elements of the plan. Although we find these requests reasonable as part of KG&E's effort to improve its financial situation without further rate increases, reconsideration of all the elements would be necessary in the event of any request to increase rates. Furthermore, it would be incumbent on KG&E to prove the reasonableness of all elements of its cost of service. Of course, the Commission also continues to have the right to reexamine all elements of KG&E's revenue requirements should it appear that its earnings or rates are unreasonably high. (Order, March 11, 1987, pg. 29)

It is abundantly clear that Commission did not intend for an increased valuation of Wolf Creek to result in higher rates. As noted in the March, 1987, order, page 11, paragraph 25, the revenue requirement increases caused by the approved treatment of Wolf Creek capital costs, including revaluation, are to be covered by the income from the insurance policies which were an integral component of the Plan. Yet the Commission is today permitting a $6.4 million rate increase without setting forth any logical basis for doing so.

If a rate increase is allowed now despite the adequacy of insurance proceeds, ratepayers are getting *no benefits* from the Rate Stabilization Plan and should expect none in the future. If there is no longer a reasonable expectation of actual rate stability, the Commission should not be so accommodating to KG&E's concerns about potential write-offs due to Wolf Creek and should consider reverting back to the original treatment found to be reasonable for Wolf Creek in Docket No. 142,098-U in 1985.

(6) After the completion of staff's audit, no hearing was held or scheduled. In light of the present situation, which includes many unanswered questions, as well as a new

rate increase of $6.4 million, customer notification and hearing should have occurred. It is vital that the public continue to have an opportunity to comment and have input on decisions affecting them.

I, therefore, respectfully dissent on the majority's approval of a new and unjustified $6.4 million rate increase for KG&E. Also, I dissent on the accounting changes approved as modifications to the Rate Stabilization Plan, based not on the merits of those changes, but on the lack of long-term analysis that they are predicated on.

/s/ Margalee Wright
MARGALEE WRIGHT
Commissioner

APPENDIX F

Order of the Kansas Corporation Commission (March 11, 1987)

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

Before Commissioners: Michael Lennen, Chairman
Margalee Wright
Keith R. Henley

Docket No. 142,098-U
84-KGE-197-R

IN THE MATTER OF THE APPLICATION OF KANSAS GAS AND ELECTRIC COMPANY for Approval of a Plan to Delay or Reduce $100 Million of Approved Rate Increases, Sustain KG&E's Progress in Restoring Its Financial Health, Establish a Framework for Rate Recognition of KG&E's Prudent Investment in Wolf Creek, and Amortize KG&E's Commission Determined Imprudent Investment in Wolf Creek.

Docket No. 142,098-U
84-KGE-197-R

IN THE MATTER OF THE APPLICATION OF KANSAS GAS AND ELECTRIC COMPANY Requesting that Interim Charges for Electric Service Be Made Permanent.

Docket No. 149,109-U
86-KG&E-3-A

IN THE MATTER OF THE APPLICATION OF KANSAS GAS AND ELECTRIC COMPANY for an Accounting Order Relating to the Amortization of AFUDC Related Tax Credits and Accounting for the Debt Component of AFUDC and Deferred Carrying Charges.

ORDER

NOW, before the State Corporation Commission of the State of Kansas, come for consideration and determination the Applications of Kansas Gas and Electric Company (KG&E) in Docket No. 142,098-U, for approval of a plan to delay or reduce $100 million of approved rate increases, sustain KG&E's progress in restoring its financial health, establish a framework for rate recognition of KG&E's prudent investment in Wolf Creek, and amortize KG&E's Commission determined imprudent investment in Wolf Creek; a request that interim charges for electric service be made permanent; and, in Docket No. 149,109-U, an accounting order relating to the amortization of AFUDC related tax credits and accounting for the debt component of AFUDC and deferred carrying charges and, further, the motion of KG&E to consolidate Docket Nos. 142,098-U and 149,109-U.

I. *Appearances*

The following parties entered an appearance in the above captioned matters:

For the Applicant/Movant, KG&E,

Jerry R. Deaver
P.O. Box 208
Wichita, Kansas 67201-0208

For the Kansas Corporation Commission Staff and the public generally,

Brian Moline
Robert L. Bezek, Jr.
Kansas Corporation Commission
Docking State Office Building
Fourth Floor, Legal Department
Topeka, Kansas 66612-1571

For Kansas Power and Light Company:

David Claycomb
Kansas Power and Light Company
KPL Tower
818 Kansas Avenue
Topeka, Kansas 66612

For the Alliance for Liveable Electric Rates:

Robert Eye
Irigonagaray, Eye & Florez
Attorneys at Law
1535 Southwest 29th Street
Topeka, Kansas 66611

For the Boeing Military Airplane Company, Beech Aircraft Corporation, Total Petroleum, Inc., the Coleman Company and General Portland, Inc.:

Curtis Irby
Bonwell, Foster, Irby & Gregory
Attorneys at Law
611 First National Bank
Wichita, Kansas 67202

For the City of Wichita:

Joe Allen Lang
Office of the City Attorney of Wichita, Kansas
Department of Law
City Hall, Thirteenth Floor
Wichita, Kansas 67202

At the hearing, the following witnesses testified:

On behalf of KG&E

Mr. James S. Haines, Group Vice President
Mr. E. D. Prothro
Mr. Earnest A. Lehman
Mr. Dick Rohlfs

On behalf of Staff

Mr. Bion C. Ostrander
Mr. Ganesh Krishnan

On behalf of Industrial Intervenors

Mr. Fred B. Adam

On behalf of Electric Shock Coalition

Ms. Mary Abbott Mills

II. *Findings of Fact and Conclusions of Law*

Having considered the evidence and testimony, the files and records, and being fully advised in the premises, the Commission finds and concludes as follows:

1. KG&E is a corporation under the laws of the State of Kansas with its principal place of business at 201 North Market Street, Wichita, Kansas. KG&E is an electric "public utility" within the meaning of K.S.A. 66-104 and is authorized to engage in the business of an electric "public utility" in the State of Kansas.

2. Notice of the above captioned applications and the Motion to Consolidate these applications and hearings were given to all parties of record and published in newspapers of general circulation in the service area. The Commission finds that notice is proper and that the Commission has jurisdiction to consider this matter.

3. KG&E filed its Application Requesting Proposed Changes in Charges for Electric Service in Docket No. 142,098-U on November 8, 1984. That Application requested an increase in KG&E's rates to cover a test year revenue deficiency of $373,427,835, principally due to the commercial operation of the Wolf Creek Generating Station (Wolf Creek), of which KG&E owns a 47 percent interest.

4. After lengthy technical and public hearings, the Commission issued Orders in Docket No. 142,098-U on September 27 and November 15, 1985 (Wolf Creek rate Orders). In those Orders, we determined that KG&E's 1985 test year revenue deficiency was $169.6 million, before fuel savings estimated to be between $25 million and $28 million, and ordered that a corresponding increase be phased into rates in four steps, as follows:

Year	Amount (Millions)	% Increase
1985	$135.0	37%
1986	20.0	4
1987	14.6	3
1988	15.6 (5 years to cover) deferred phase-in revenues)	3

5. The first increase became effective on October 3, 1985 and the second increase became effective on September 27, 1986. Both increases went into effect on an interim basis and, with its July 25, 1986 Application Requesting That Interim Charges For Electric Service be made Permanent in Docket No. 142,098-U, KG&E has requested that such increases be made permanent.

6. In our September 27, Wolf Creek rate Order, we recognized that granting KG&E less than it requested could have a serious impact on KG&E's financial health.

7. In response to the Wolf Creek rate Orders, KG&E took a number of cost saving measures. KG&E cuts its common dividend in half, eliminated 200 jobs, cut 20 percent of its construction budget, froze officers' salaries,

eliminated management incentives, greatly reduced civic and charitable contributions, curtailed involvement in industry and professional associations, and initiated cost control measures over many expenditures not necessary in providing direct customer service. Additionally, KG&E has engaged in extensive refinancing to both lower its embedded cost of debt and retire a majority of its preferred stock.

8. While KG&E's cost cuts and economic refinancing have lessened the financial impact of the Wolf Creek rate Orders, KG&E believes that these changes have not established sustainable progress toward the restoration of its financial health. Toward that end, in Docket No. 149,109-U, KG&E asked the Commission to approve two accounting changes which would improve KG&E's financial condition without an immediate need for a rate increase. KG&E sought Commission approval to (a) accelerate the amortization of construction related tax credits to an eight year schedule, rather than over the entire depreciable life of the property which gave rise to the credits, and (b) capitalize the deferred carrying charges that the Commission permitted with respect to KG&E's physical excess capacity in Wolf Creek using a before tax (gross) rate of return for preferred stock and long term debt rather than the current net of tax rate.

9. Our March 12, 1986 Order in Docket No. 149,109-U approved the accelerated amortization of construction related tax credits, while deferring action on the proposal dealing with deferred carrying charges.

11. KG&E has also acted to retain its existing sales base by negotiating to prevent the loss of major customers for whom, during the present period of time when KG&E has a large surplus of generating capacity, cogeneration presents a cost savings opportunity at the expense of other customers. Significantly, KG&E has made no effort to shift to other classes of customers the revenue shortfall which has resulted from the negotiation of

special rate contracts. Such shortfall, which has been reasonably estimated to be $4 million over the 5-year term of the contracts, is material and it diminishes the beneficial impact of the steps KG&E has taken to improve its financial situation.

12. On December 9, 1986, KG&E filed an Application in Docket No. 142,098-U in which it requested approval of a Plan which it contends will permit continuation of its efforts to improve its financial condition while permitting customers to save approximately $100 million over the next five years. KG&E describes the Plan as having four interdependent components: (a) approximately $100 million of delays in previously granted rate increases and reductions in certain rates to enhance the economic viability of KG&E's service territory and efficient use of KG&E's generating facilities, (b) a basis to sustain KG&E's progress in restoring its financial health, (c) a specific framework for the rate recognition of KG&E's prudent investment in Wolf Creek, and (d) amortization of KG&E's imprudent investment in Wolf Creek. At hearing, Mr. Deaver requested and was granted leave to make three oral amendments to KG&E's December 9 Application.

13. KG&E's proposed Plan depends on an approximate $800 million stream of income in excess of premium expense which KG&E expects to receive over the next 40 years as the owner and beneficiary of life insurance policies on 82 of its directors, officers and key employees. KG&E states that the life insurance policies will be funded entirely by KG&E's shareholders. KG&E proposes to combine this stream of income with utility operating revenue to cover its jurisdictional cost of service in Kansas, including a return on its prudent investment in Wolf Creek.

14. KG&E states that its Plan will permit a delay from September 27, 1987, to January 1, 1989, of the third increase approved in the Wolf Creek rate Orders.

A pending issue before the Commission in Docket No. 142,098-U at the time the KG&E application was filed was whether it was reasonable and prudent for KG&E to retire its Ripley Station. KG&E requests that the revenue impact of this issue be added to the third increase, as delayed. Under its Plan, KG&E also proposes a delay from September 27, 1988 to January 1, 1992 the fourth increase approved in the Wolf Creek rate Orders. That increase was approved as a temporary five year increase, and KG&E has requested that it be approved as a permanent increase. Under KG&E's Plan these delayed third and fourth rate increases would be approved now, and become effective on a permanent basis on January 1, 1989, and January 1, 1992, respectively, and to be spread on an equal percentage basis to each component of each rate schedule. KG&E believes that these proposed delays, if adopted, would have KG&E's customers approximately $80 million over the next five years. KG&E believes the remaining $20 million of customer savings over the next five years would come from the proposed reduction to 5¢ of its current rate of 7.14¢ per KWH for residential and farm electric space heating customers' usage above 500 KWH per month during the non-summer months (all months except June, July, and August). We note that KG&E suggested at hearing that its December 9, 1986, Application understates the customer savings from this proposed reduction. The company contends that the savings over the next five years is more likely to be $27 million, as the annual savings are expected to be $5.4 million.

15. KG&E states that the viability of its Plan requires that it be permitted to retain the benefits of its cost-cutting measures, economic refinancings and the savings due to the new federal tax law. Further, KG&E requests that the Commission reconfirm one accounting change and authorize two others: (a) accelerate to eight years the amortization of construction related tax cred-

its, as already approved in our March 12, 1986 Order in Docket No. 149,109-U, and (b) accrue carrying charges on the portion of Wolf Creek which constitutes physical excess capacity at KG&E's 4.91 percent before tax (gross) weighted cost of debt rate applied to KG&E's investment of $2,376 per KWH with this accrual to cease December 31, 1991, and capitalize an 11.995 percent before tax (gross) return on deferred phase-in revenues, with such accruals to be amortized on a sinking fund basis over Wolf Creek's remaining depreciable life, and (c) extension of Wolf Creek's depreciable life to 40 years for a composite annual depreciation rate of 2.61 percent for its share of Wolf Creek.

16. KG&E's December 9, 1986, Application in Docket No. 142,098-U also restated KG&E's July 25, 1986, request that the first and second increases under the Wolf Creek rate Orders, presently in effect on an interim basis, be made permanent.

17. KG&E also requests that it be permitted to amortize over five years the $6.4 million deferred asset which represents the allowed costs of operating Wolf Creek from the commercial service date to the effective date of the Wolf Creek rate Orders.

18. KG&E's Plan further would have us find, under the methodology of the Wolf Creek rate Orders, that the excess portion of KG&E's Wolf Creek capacity currently is 269 MW and that KG&E estimates this excess should be reduced by 53.8 MW on January 1 each year from 1988 through 1992, so that KG&E would stop accruing deferred carrying charges on excess capacity by December 31, 1991, and then begin amortizing the accrued charges by January 1, 1992. KG&E has also proposed that if we later determine the retirement of Ripley Station to have been reasonable, the amount of excess capacity should be reduced by 46 MW to 223 MW and the annual reduction should be 44.6 MW.

19. Under its Plan, KG&E would accrue deferred phase-in revenues with carrying charges based on an 11.995 percent before tax (gross) rate of return, compounded semi-annually, until such time as the delayed third rate increase becomes effective, and then accrue the carrying charges on accumulated deferred phase-in revenues until the delayed fourth rate increase becomes effective. At that time the amortization of the accruals on a sinking fund basis over Wolf Creek's remaining depreciable life would begin.

20. Finally, KG&E's December 9, 1986 Application in Docket No. 142,098-U requests that we permit KG&E to amortize above the line, in cost of service, and over Wolf Creek's remaining depreciable life the undepreciated portion of the $128 million of KG&E's investment in Wolf Creek which we have found to be imprudent, and then find that the Plan permits rate recognition of KG&E's investment in Wolf Creek beginning January 1, 1992.

21. Due to the interrelationship of the accounting authority requested by KG&E in Docket No. 149,109-U and the Plan set out in KG&E's December 9, 1986, Application in Docket No. 142,098-U, we find that it is appropriate and reasonable to consolidate Docket No. 149,109-U with Docket No. 142,098-U.

22. The KG&E Plan contains many elements, which are each addressed below. Although we approve of each of the Plan's individual elements with some modifications, it should be noted at the outset that many of those elements, standing alone, would likely not normally receive Commission approval. It is only within the context of the total Plan that we sanction all the separate components. As discussed below, each element of the Plan has real or potential benefits or detriments for ratepayers. Indeed, many elements have effects which vary over time so that they cannot be characterized as wholly beneficial or detrimental to ratepayers. For example, the accounting

changes decrease the costs of service during the early years of the Plan, but increase them in later years. On the other hand, the income from the life insurance policies will not be significant in the early years of the Plan, but increase gradually to over $30 million in the later years. Because the effects of the individual elements of the Plan vary over time, so do the net combined effects. In any given year, of course, the net effect of the Plan can be determined, but we have focused more on the totality of the Plan and its potential benefits for both ratepayers and KG&E.

23. The primary benefits of KG&E's Plan, from the perspective of ratepayers, is the deferral of already authorized rate increases, a rate decrease for space heat customers and the likelihood of no additional rate increases related to Wolf Creek capital costs other than those provided for by this order. This Plan contemplates only one rate change which was not explicitly envisoned by our original Wolf Creek orders, the $15.6 million fourth step permanent increase, which was originally to terminate after five years once carrying costs on deferred phase-in revenues were recovered. As noted below, however, the continuation of the rate increase in 1998 may well be justified by greater need for Wolf Creek capacity in any event. In fact, greater or additional rate increases due to changes in circumstances expressly contemplated in our original order, such as capacity additions or a valuation adjustment, would be a real possibility. However, the Plan would permit ratepayers to avoid such rate increases. As Mr. Haines testified, ". . . the Plan permits rate recognition by January 1, 1992, of KG&E's prudent investment in Wolf Creek such that, assuming reasonable circumstances, no further rate increases will be needed as the amount of Wolf Creek considered to physically excess is reduced or as coal capacity, becomes more expensive." (Haines, Tr. 61). No only does the Plan forstall indefinitely rate increases due to

Wolf Creek capital costs, but also delays for a significant time the need for rate increases due to other cost increases. As stated by KG&E witness Haines, the Plan provides "a very good probability" that no rate increases would be necessary in the next five to ten years for increases in costs of service than Wolf Creek. (Haines, Tr. 113).

24. The delays in previously scheduled rate increases and the reduction in the space heat rate obviously provide real benefits to ratepayers but they are also beneficial to KG&E. Thus, Mr. Haines explained the proposed rate delays and reduction as KG&E recognition "that its health is inextricably tied to the health of its service territory. Economically efficient use of KG&E's generating facilities results from making KG&E's electric service affordable and useful." (Haines, Tr. 53). The Commission continues to be concerned about the level of KG&E's rates. KG&E, along with KCPL, have by far the highest rates in Kansas of a generating utility and the highest retail rates of an investor-owned utility. Furthermore, those rates are significantly above the normal average. It was thus not surprising that KG&E witness Lehman stated that KG&E's principal means of encouraging conservation is through its "overall rate level, which is high." (Lehman, Tr. 337). Although Mr. Lehman was being partially facetious, it is a fact that KG&E's rates are high. It is encouraging that KG&E now recognizes the need to keep rates reasonable, not only for the sake of ratepayers but also for the good of the company. The possibility of real rate stability with limited future rate increases consequently leads us to conclude that the Plan as a whole is acceptable.

25. Before turning to the individual elements of the Plan, we should further address some of the overall concerns about the Plan. Because of the requested treatment of Wolf Creek capital costs and the requested accounting charges, KG&E's revenue requirements under

traditional rate making would theoretically increase in the future. KG&E, however, asserts that any and all such increases would be covered by the income from the insurance policies. Because the projected income of $800 million is a net of tax amount, it will supplant a much greater incremental amount if analyzed in terms of revenue requirements. It is this feature of the Plan which allows for the promised rate stability and further persuades the Commission to allow retention of the income tax and other cost reductions. Without such long term contributions from the shareholders, it would be inequitable for ratepayers to totally forego the benefits of the income tax and other cost reductions, while also facing ratemaking and accounting changes which theoretically increase future revenue requirements. KG&E witness Haines also responded to staff concerns about the large revenue requirements created by the Plan. He noted that KG&E's earnings under the Plan are better than under conventional ratemaking treatment. Furthermore, he stated that KG&E could not automatically come in and obtain conventional rate recognition of 100 percent of its prudent investment in Wolf Creek and the Plan was approved. "When the reasonable rate doctrine is considered, it is very probable that at least over the next 10 years, KG&E would not be permitted to charge any higher rate with the Plan than without it." (Haines, Tr. 476-77).

26. The other threshold question before the Commission is whether KG&E does, in fact, require its requested changes in order to "restore its financial health." We noted previously that KG&E has taken several measures to reduce its costs in order to cope with our 1985 orders. However, the record indicates those orders have not had consequences as dire as predicted by some. KG&E stock has recently been selling at $23.50 a share, a ten year high. Although the expected earnings per share for 1986 is around $1.40, down from $2.13 in 1985 due to cessa-

tion of AFUDC, KG&E believes that "Relative to where we were a year ago, we're certainly doing quite well and we are pleased with that." (Haines, Tr. 74). Nonetheless, the Commission does agree that improvement in KG&E's financial picture is desirable for all concerned if it can be accomplished at a reasonable cost to ratepayers. Indeed, the Commission has previously taken a step in that direction in approving the accelerated amortization of construction raised tax credits. Under the KG&E Plan, the company projects that it will be able to earn a return on total equity, including equity associated with Wolf Creek costs found to be imprudent, which will range between 8.69 percent and 10.39 percent for the ten years period of 1986 through 1995. KG&E suggests that these are "minimally adequate" returns but also notes that it is exploring other mechanisms, such as a sale-lease back arrangement, which will further improve its situation. Although the Commission would not necessarily agree that those projected returns are "minimally adequate," especially since they include a return on imprudent investment, we do agree that there should be no need for further rate increases related to Wolf Creek capital costs with such returns.

27. The first individual element of the Plan is the life insurance plan. KG&E will be permitted to combine its projected $800 million stream of income from corporate owned life insurance over the remaining life of Wolf Creek with utility operating revenue to cover KG&E's Kansas jurisdictional cost of service, including a return on KG&E's investment of $2,376 per KW in Wolf Creek. Some questions were raised concerning the amount KG&E would actually receive, as well as the certainty of KG&E actually receiving the $800 million over the next 39 years. Witnesses for KG&E testified that this is a conservative or worst case projection. Indeed, Mr. Prothro testified that under more favorable assumptions, KG&E could receive as much as a billion dollars. A potential significant

risk, according to KG&E, is a change in federal tax laws which would adversely affect the insurance policies, although we note that tax law changes have traditionally been prospective in nature, as opposed to retroactive in nature. The utilities we regulate are always subject to the risk of future laws which would upset previous assumptions concerning cost of service. However, in view of the potential benefits to customers and shareholders of KG&E, we consider this risk to be reasonable. Consistent with its proposal, KG&E is directed to fund the corporate owned life insurance exclusively with shareholder funds. Normally it is not permissible to combine income from shareholder funded, non-utility assets with utility operating revenue to cover the cost of providing regulated utility service. In this case, however, we find that it is appropriate because KG&E has requested such treatment, and KG&E's shareholders will benefit from other aspects of the Plan.

28. KG&E is permitted to delay from September 27, 1987 to January 1, 1989 the third increase previously approved in the Wolf Creek rate Orders. In a separate Application in Docket No. 142,098-U, the Commission has determined that it was reasonable and prudent for KG&E to retire its Ripley Station. The Commission directs that the revenue impact resulting from the Ripley retirement be added to the third increase and become effective on a permanent basis on January 1, 1989, with one condition. KG&E also requested that such incremental revenue impact be accounted for from September 27, 1985, until January 1, 1989, as deferred phase-in revenues. Although we found the Ripley retirement was reasonable, the evidence does not support this aspect of KG&E's Plan. KG&E's actual normalized peak in 1986 was 40 MW below its forecasted peak. Consequently, we cannot find that it is reasonable to permit KG&E to accrue deferred phase-in revenues for an additional 46 MW of Wolf Creek to balance the loss of 46 MW from Ripley. At the same time, it is reasonable to assume that KG&E's need for

Wolf Creek, whether from peak growth or reduced overall generating capability, will have grown by 41 MW from 1986 to 1988 so as to justify adding the incremental revenue impact to the January 1, 1989, increase. Also, as a condition precedent to the inclusion of revenues associated with the Ripley retirement in the January 1, 1989, rate increase, we direct the company to show the Commission that this demand growth or reduced overall generating capacity has occurred. Additionally, the revenue impact should be determined using an overall cost of capital equal to KG&E's rate of return on deferred revenues as of January 1, 1989, as set forth in paragraph 31, and should reflect Wolf Creek's accumulated reserve for depreciation as of January 1, 1989.

29. KG&E has requested the authority to delay from September 27, 1988 to January 1, 1992, the fourth increase of the phase-in approved in the Wolf Creek rate orders. When both the third and fourth increases are delayed, KG&E customers will save approximately $80 million. This particular portion of KG&E's plant is definitely beneficial to ratepayers. KG&E is permitted to delay the fourth increase, as requested.

30. KG&E's request to spread the third and fourth increases on an equal percentage basis to each component of each rate schedule is approved as being fair and reasonable. This method of rate design is consistent with the previous Wolf Creek Orders, and staff did not object to this method of spreading these increases.

31. KG&E is directed to capitalize the delayed revenue increases and a rate of return on such deferral using the before tax (gross) method. The rate of return on deferred revenues shall reflect KG&E's actual weighted cost of debt and preferred as determined annually from its official annual report to the Commission (Form No. 1). The authorized return on common equity will remain at 15.5 percent. The return on deferrals shall be compounded semiannually. Staff witness Mr. Ostrander testi-

fied that the September 27, 1985 Order in Docket No. 142,098-U does not permit semi-annual compounding. While we tend to agree with staff that the language of the Order at paragraph 8 on pages 133 and 134 does not permit semi-annual compounding, we can understand the company's belief that the language is ambiguous. However, the only question before us today is whether KG&E may semi-annually compound the deferrals. We hereby grant specific authority for KG&E to do so.

32. KG&E, in its application, requests that it be permitted to place the third and fourth increases of the phase-in of the Wolf Creek rate order into effect on a permanent basis. The Commission notes at the outset that it is normally hesitant to grant permanent rate increases such as the increases contemplated by KG&E's Plan, on a prospective basis. In the regular rate making setting such a prospective treatment normally includes a great deal of speculation due to the nature of the future. However, it should be noted that as part of the original Wolf Creek Order, the Commission has already granted the third and fourth phase-in steps on a interim basis. Indeed, the Commission approved the interim steps to become effective in 1987 and 1988. The Commission notes with approval the company's plan to delay these increases until 1989 and 1992. The Commission believes that these defferals are a true benefit to the consumers of KG&E's services. Both staff and the company seem to agree that the benefit of the delays in the third and fourth rate increases will result in a savings to KG&E customers of the magnitude of $80 million. Thus, in light of the delay that KG&E is willing to accept in delaying the increases in balance with other portions of the plan, the Commission believes it is reasonable to allow KG&E to file tariffs showing that the third and fourth phase-in increases are permanent increases. However, we note by this action that we have not foreclosed the possibility of further challenge to the third and fourth increases. Nor is our action inconsistent with the possibility that at some point

after the increases become effective that it would be appropriate to examine the reasonableness of KG&E's earnings. Indeed, it is likely that the Commission will wish to review this aspect of the plan in the latter part of the next decade. If no earlier action is necessary, any customer of KG&E, as well as the Commission staff, is always free to file a complaint alleging that KG&E's rates are unreasonable. It should be noted, as stated in other parts of this order, that the Commission believes the increases should be spread on an equal percentage basis to all components of each rate schedule.

33. KG&E, through Mr. Lehman, presented evidence which suggests that, at its present rate of 7.14¢ per KWH for residential and farm electric space heating customer's usage above 500 KWH per month during non-summer months (all months excepting June, July and August), KG&E will gradually lose space heating load. Thus in the instant application, KG&E has proposed to reduce its residential and farm space heating rate from the current 7.14¢ to 5.00¢ per KWH for all KWHs in excess of 500 KWHs. In addition, KG&E has indicated that if its proposed reduction is approved, it will not seek to recover the short run revenue loss from other customers. However, if the proposed reduction is not approved, KG&E believes that over the next ten years the loss of revenues and market share will grow to significant levels.

KG&E's evidence at hearing showed that the proposed reduction to 5¢ per KWH would result in a revenue loss of approximately $5.4 million in the first year of reduction, but within 6 to 7 years would result in greater revenues than would have been produced had the 7.14¢ per KWH rate remained in effect. The Staff, through its witness Dr. Krishnan, found substantial problems with the method and model used for estimating KG&E's revenue loss by Mr. Lehman. Dr. Krishnan found that in the econometric model used by KG&E one

of the variables, specifically the gas-to-electric price ratio variable, was not statistically significant and in no way furthered the econometric model's reliability. Indeed, Dr. Krishnan testified that the gas to electric price ratio variable was statistically insignificant. Additionally, Dr. Krishnan believes that the perfect inelasticity of demand contained within the econometric model was an unrealistic assumption. While we find that Staff's evidence as to the econometric model to be reasonable, we note that KG&E's willingness to forego recover the short-run revenue loss from other customers, and in effect underwrite that loss itself, is a significant factor in favor of this particular component of the Plan. Thus, the Commission finds that the reduction in space heating rate to 5.00¢ per KWH reasonable. But, the Commission recognizes that the proposed cut-off of 500 KWH, is, in reality, a substitute for accurate metering. A more realistic cut-off figure above which the space heating rate would apply is 650 KWH. Therefore, for all residential consumers who are eligible for the space heating rate, the cut-off will be 650 KWH. However, an exception shall be all-electric apartments. Apartments average a lower kilowatt per hour use, and therefore the space heating cut-off for apartments should be set at a lower rate, 500 KWH. Therefore, the space heating rate reduction is approved, and the reduction will be allowed for usage over 650 KWH for residential, and 500 KWH for residential apartments.

The Commission also recognizes the lack of specific use data on space heating, and further, that the cut-off levels as specified do not reflect precisely space heating use. The lack of accurate metering is a probem when implementing targeted-use rates. Therefore, an investigation shall be commenced by the Commission to look at the benefits of separate metering. Also, the specific usage information on space heating shall be gathered by KG&E, and the cut-off levels re-evaluated in the above referenced investigation.

34. The Commission has a number of other concerns of a general nature with the reduction of the space heating rate. The Commission notes that in reducing the rates the company has set out on a plan that could be construed as being contrary to long term planning and conservation. This Commission and the company have a significant interest in the long term planning and conservation of utility resources in Kansas. It is understandable that KG&E plans to aggressively market their product and try to sell more electricity. Indeed, growth is a desirable goal. However, it appears that KG&E's goal extends past space heating; it wishes to increase the number of all electric homes and apartments. (KG&E Servicegraph, Vol. 52, Issue 12, Dec. 1986). While this goal is understandable, it makes the Commission's role as overseer of the public interests even more important. Thus the Commission believes that it must mandate conservation and load management goals as a part of this docket. We must make sure that the growth that does occur is efficient, planned growth. It is important that the approval of the space heating rate be seen for what it is; an attempt to target a specific use of electricity that will increase off-peak load, and therefore overall efficiency. The Commission wishes to specifically note that its space heating findings in this docket is not a signal for any utility to unreasonably market its product which would ultimately increase its peak demand.

35. As part of its Plan, KG&E has requested that it retain the benefits resulting from its cost cutting measures. KG&E, through Mr. Haines and Mr. Prothro, testified that due to its own initiative KG&E has managed to save approximately $5 million dollars for 1986, on a net of tax basis. Staff, through Mr. Ostrander, testified that KG&E has "made a strong case for the proposition that it be allowed to retain the benefits of cost cutting measures that it has initiated." (Ostrander prefiled direct testimony, p. 20, line 15-18). We agree with staff,

and approve KG&E's request as to the retention of benefits from cost-cutting measures.

36. KG&E has also requested the authority to retain the benefits of economic refinancing of its debt and preferred stock charges. KG&E states that it has aggressively taken advantage of declining interest rates so that the company has saved approximately $20 million. Staff, through Mr. Ostrander, took the position that these savings are not the result of particularly innovative or creative actions of KG&E, but merely the result of federal policy initiatives. Traditionally, this Commission has believed that absent compelling rationales, savings due to declining interest rates should flow through to ratepayers. However, when this component of the plan is balanced against the other factors of the plan, such as the insurance revenues, rate delays and reductions and the likelihood of no further Wolf Creek related rate increases outside of this order, we find the request to retain the benefits of economic refinancing to be reasonable. However, the Commission has determined that KG&E shall update annually the cost of debt to actual which is reflected in the carrying charge and deferred revenues calculation. This matter is further elaborated on later in this order.

37. KG&E also requests the authority to retain the benefits of the 1986 Tax Reform Act. This particular provision of the plan raises important concerns for the Commission. Indeed, this Commission is initiating a generic docket which will deal with the issue of retained tax savings due to the Tax Reform Act. KG&E argues in its application and testimony that the retention of tax savings is critical to the success of the plan. Staff, in the alternative, argued that KG&E will incur no risk if the tax rates increased, while retaining all of the benefits if tax rates decreased. Additionally, staff suggested an interesting threshold analysis which could be used in future rate cases. (Ostrander prefiled direct, p.

22-24). Traditionally, this Commission has believed that utility rates should reflect actual tax rates, not tax rates that are higher (which unduly benefit the utility) or lower (which unduly benefit the ratepayer), than actual. The Commission still believes in this policy.

However, this plan presents the issue of tax savings in a different manner. Along with the tax savings, KG&E proposes to allocate $800 million of its own revenues, and delay rate increases which will save ratepayers $80 million, and reduce the space heating rate resulting in another $20 million in rate savings to ratepayers. Additionally, KG&E maintains that it can live within the constraints of this plan so that no future Wolf Creek related rate increases will be necessary. While the tax benefit issue, if viewed in isolation seems at odds with established Commission policy when the issue is placed in context as a part of a creative, innovative plan that purports to generate significant benefits to both ratepayers and KG&E, the analysis used by the Commission, and ultimately the results reached, must be different. Therefore, as a part of this comprehensive plan, and indeed specifically conditioned upon the other ratepayer beneficial aspects of this plan, the Commission approves KG&E request as it relates to tax law savings.

However, the Commission believes that any additional tax savings above those anticipated by KG&E should be considered for return to the ratepayers. Therefore, during the period 1987 through 1992, KG&E is directed to file with the Commission by April 1, of each year a report which shows the increase to its previous year's operating income which result from benefits of the Tax Reform Act of 1986. If, during these years, the actual benefits as reported by the company and after investigation and confirmation by staff, exceed the amounts projected by KG&E (Exhibit 1, Schedule EDP-6), the excess shall be subject to refund, perhaps on a cumula-

tive basis if the circumstances warrant. If there are any refunds, the refund shall include an interest charge using the authorized rate for consumer deposits. We would except that an especially careful review would occur prior to the presently scheduled rate increase on January 1, 1989.

38. The Company, in its application, requests that it accrue the debt component of deferred carrying costs for the physical excess portion of Wolf Creek on a "before tax basis," and accrue carrying costs on deferred phase-in revenues on a "before tax basis." By its application, KG&E has asked that the preferred equity component of this accrual be eliminated. Additionally, the plan calls for KG&E to cease the accrual of carrying charges on excess capacity on December 31, 1991, and on January 1, 1992, begin to amortize those costs to cost-of-service using a sinking fund method over the remaining depreciable life of Wolf Creek. Further, KG&E asks the Commission to reconfirm its decision regarding accelerated amortization of construction related tax credits found in Docket No. 149,109-U. As can be readily seen, these aspects of the plan are intricate, and to a large degree merge into other aspects of the plan, specifically ratable capacity addition and a determination of the depreciable life of Wolf Creek.

The Commission does, at this time, reconfirm our earlier decision regarding construction tax credits found in Docket No. 149,109-U. We also find the KG&E request as stated above to be reasonable and appropriate for the following reasons and with the following changes. This Commission realized when it formulated the original Wolf Creek orders that eventually the issue of amortizing the accumulated deferral cost related to excess capacity back into cost of service would have to be dealt with. Although this particular amortization mechanism was not what we had envisioned, we are pleased that KG&E has found a method to deal with this issue that

does not result in an increase in rates to KG&E customers. In regard to the accrual portion of this mechanism, we find the KG&E request reasonable with two modifications. First, we find that staff's recommendation that the cost debt component be updated to accurately reflect the current cost of debt to have a great deal of merit.

Second, we find that KG&E should reflect the actual preferred cost of equity in its accrual charge. Therefore, KG&E is permitted to accrue carrying charges on the physical excess capacity portion of Wolf Creek on a before tax (gross) rate which reflects KG&E's actual cost of debt and preferred stock as determined annually from its official annual report to the Commission (Form No. 1). This accrual will cease on December 31, 1991, and on January 1, 1992, will be amortized on a sinking fund basis over Wolf Creek's remaining life.

39. When considering the comprehensive nature of the proposed Plan, KG&E's request to extend Wolf Creek's depreciable life to 40 years is reasonable. Ample foundation exists in the record of Docket No. 142,098-U to support this change. Although KG&E stipulated to a Staff proposed depreciation rate for purposes of the Wolf Creek rate case, KG&E did so without implication as to the useful life of the plant. Based on the evidence in the record, the Staff proposal was only one of a number of reasonable approaches the Commission could have adopted. Indeed, in the Wolf Creek orders we noted that we could readdress this issue in the future, and did not foreclose the use of alternative depreciation rates. Given the design, construction and operation and maintenance of Wolf Creek, it is reasonable to find that its operating life could be 40 years. We also note that KG&E's Nuclear Regulatory Commission operating license for Wolf Creek covers a period of 40 years. KG&E is directed to establish a composite annual depreciation rate of 2.61 percent, based upon a 40 year depreciable life, for its investment in Wolf Creek.

40. KG&E is ordered to amortize over five years the deferred asset of $6.4 million representing the allowed cost of operating Wolf Creek between the commercial service date and the effective date of the Wolf Creek rate Orders. Implicit in the creation of this deferred asset was the requirement that the asset would eventually be charged back to cost of service. Under KG&E's Plan, however, the Commission finds that this asset can be amortized to the Kansas jurisdictional cost of service over the next five years without requiring additional revenue from ratepayers.

41. In the Wolf Creek rate Order, we found that KG&E had generating capacity in excess of peak plus reserve of 327 megawatts. Consequently, 327 megawatts of the capacity of Wolf Creek was found to represent excess physical capacity. In support of its application to make interim charges permanent, KG&E calculated its excess capacity to be 223 megawatts, using the methodology found in the Wolf Creek rate Orders. In those Orders we had determined that a five year forecast period for peak demand was reasonable given the facts that were before us, and therefore selected 1990 as the reference year for the calculation of excess capacity. KG&E used the five year forecast method of analysis in its Application for permanent rates to be consistent with the Wolf Creek rate orders and to reflect the passage of one year from the time of those Orders. Though we agree that 1991 is the proper reference year for determining KG&E's need for capacity with respect to this application, we note that KG&E's actual normalized peak demand in 1986 was 41 MW below KG&E's own forecasted peak. While KG&E's application to make interim charges permanent assumes that 100 percent of Ripley capacity is excluded. It also assumes that KG&E's actual normalized peak in 1986 would equal its forecasted peak. The 41 MW shortfall in the actual peak virtually balances the incremental 46 MW attributable to Ripley. Since we

found this retirement of Ripley was reasonable, prudent, under the methodology used in the Wolf Creek rate Orders we find that the excess portion of KG&E's Wolf Creek capacity is 269 MW. Although 269 MW of excess capacity is significant, and normally would be excluded from cost of service, we believe that KG&E's plan successfully deals with our concerns. KG&E's plan calls for the ratable inclusion of capacity so that at the end of five years (December 31, 1991) KG&E would have no excess capacity attributable to Wolf Creek. Further, KG&E states that the ratable inclusion of capacity will not result in a rate increase outside of those increases granted in this order. It is interesting to note that KG&E's load forecasts show that if the Commission were to still use the five projected load method of calculating excess capacity, all of KG&E's current excess capacity would be used by the mid 1990s. However, even with the likelihood of future load growth, if this aspect of the plan were analyzed in isolation it would not meet the criteria established in Wolf Creek rate order. Under KG&E's plan, however, the benefits of rate stability combined with the other beneficial aspects of this plan allow the Commission to find that the reduction of excess capacity by 53.8 MW on January 1 of each year through 1991 to be reasonable. The Commission further notes that when this provision is combined with the amortization of deferred costs associated with excess capacity, a potential problem to both ratepayers and shareholders has been solved to the benefit of both ratepayers and shareholders.

42. In light of the Commission's approval of KG&E's plan for coping with the problems associated with the problems associated with the Wolf Creek Plant, we believe a few additional requirements are in order. There is little doubt that construction of unneeded or excessively expensive generation causes enormous difficulties for utilities and ratepayers. One obvious lesson of Wolf Creek is that utilities need to aggressively pursue pro-

grams which efficiently manage the timing and need for generation. This responsibility complements the Company's obligation to provide efficient and reliable service without any lapse. This Commission has regularly expressed its belief that various Demand Side Management programs, such as conservation, time of use rates, and load management should be given equal status with Supply Side Planning. KG&E's Load Management Control Program is of particular interest to the Commission because of the significant impact it could have in lowering and controlling growth of the Company's summer peak demand. The Commission notes with approval that KG&E currently has over 5,400 residential and commercial customers participating in its load management program providing KG&E with up to 11 MW of load management. The Commission believes that KG&E should aggressively seek and attain its self-established corporate goal of 100 MW of peak shaving capability. We therefore require that KG&E report in writing to the Commission staff, by December 1 of each year: (1) KG&E's existing load management capability; (2) the anticipated addition to that capability for the next year; (3) the current corporate goal, with an explanation of why it is less than 100 MW, or why it cannot be higher than 100 MW; (4) a listing of promotional/educational efforts in the past year by KG&E to let customers know the details of the load management program, as well as an update on how those efforts will be increased or perfected in the coming year; (5) the amount by which the previous year's summer peak demand was reduced through utilization of the company's load management program; (6) the estimated in-service date and estimated capacity of new plant additions over the next 10 years, and; (7) a copy of the economic analysis supporting the type of generation favored versus the reasonably available alternatives. In addition, the company shall submit by June 1 of each respective year the Load and Capability Forecast for that year. Also, the Commission encourages KG&E

to work with Kansas Electric Utilities Research Program (KEURP) regarding load management.

43. KG&E, in its application, requests that we revalue Wolf Creek from our previously determined value of $1290 per KW to the full cost of $2376 per KW. In the original Wolf Creek rate orders we stated that at the value of $2376, Wolf Creek was an economically inefficient and excessively expensive means of providing electricity to ratepayers. Furthermore, we found that full rate base inclusion of Wolf Creek at $2376 per KW would not reflect economic efficiency in that its generating capacity could have been provided at a more reasonable cost to ratepayers. Thus, while we allowed full recovery of the cost of construction of Wolf Creek, (except the prudence adjustment, which is analyzed in paragraph 44) we were determined to share the risk of this excessively expensive plant between shareholders and ratepayers. Therefore, we determined that while the utilities could receive a return on the value of $1290 per KW through rates, the ratepayers would not contribute to the return on the costs over $1290 per KW.

Since the determination of $1290 as the value of Wolf Creek resulted from an analysis of the relative cost efficiencies of nuclear and coal plants, we expected to revisit the issue of the value of Wolf Creek and the division of risk for uneconomical plant between ratepayer and shareholder at a later date. In the application before us, KG&E has proposed a method for dealing with the issue of value in a way that deals successfully with our concerns of risk sharing. KG&E proposes to increase the value of Wolf Creek to $2376 per KW while at the same time not requiring rate increases beyond what is contemplated in this order. Although there is no firm basis for reassessing the cost efficiencies of Wolf Creek, there is a sense in which the value of the plant has increased. Since the KG&E plan contemplates no further rate increases, it could be said the plant is more beneficial to ratepayers. Fur-

ther, a higher valuation will allow KG&E to improve its financial situation. Therefore, to the extent that KG&E can improve its financial situation while holding the line on rate increases, both KG&E and ratepayers benefit from the increase in value of Wolf Creek from $1290 per KW to $2376 per KW. Of course, if the predicates to the revaluation were to change, (i.e., rate stabilization, benefits to ratepayers and shareholders, etc.), the analysis of this Commission could also change. Additionally, consistent with this finding, KG&E is also permitted to accrue carrying costs on Wolf Creek's excess capacity valued at $2376 per KW.

44. In the Wolf Creek rate Orders, the Commission found that $128 million of KG&E's share of Wolf Creek construction costs was inefficiently and imprudently incurred. As part of its Plan, KG&E is now requesting an above the line amortization of its Commission determined imprudent investment in Wolf Creek over the plant's remaining depreciable life. KG&E does not seek a rate of return on the undepreciated portion of the imprudence disallowance. The Commission expressly reaffirms its finding that $128 million of KG&E's investment in Wolf Creek was inefficiently and imprudently incurred. Amortization above the line to cost of service, however, is justifiable under KG&E's Plan because it will not require increases in rates above the levels contemplated by the Wolf Creek rate Orders and this Order. As a component of this Plan, and specifically conditioned on implementation of the other aspects of this plan which are beneficial to ratepayers, KG&E will be allowed to amortize above the line the previously disallowed imprudent portion of its investment in Wolf Creek over the plant's remaining depreciable life. We note that while K.S.A. 66-128c prohibits a return on costs which we have found to be imprudent, K.S.A. 66-128c permits us to exercise discretion in allowing a return of those costs. From the ratepayers' perspective, as long as such costs do not require an increase in

rates, the fact that they were originally imprudently incurred is of less significance. This, of course, is not the case if return of such costs would result in rate increases. In such an event, our prior disposition of imprudent costs would be appropriate.

45. Finally, KG&E has restated its request that the first and second increases under the phase-in plan approved in the Wolf Creek rate Orders be made permanent. In the Wolf Creek rate Orders, we found that the initial rate increase under our phase-in plan should be interim in nature until six months of actual operating results for Wolf Creek became available. More than six months of Wolf Creek operations have occurred. Mr. Prothro testified that the cost of operating and maintaining Wolf Creek during its first year of operation was approximately $77 million while the projected O & M expense utilized in the Wolf Creek rate Orders was approximately $65 million. Uncertainties about the operation of Wolf Creek and the level of Wolf Creek O & M expenses have been resolved and, therefore, it is reasonable to permit the first two increases to become permanent.

46. The Commission's findings and conclusions in this Order should not be construed as surrendering or limiting the broad authority to review and evaluate the efficiency or prudence of any actions of KG&E, as such authority is granted to it under K.S.A. 66-128, *et seq.* Nor should this Order be construed as a finding that KG&E's prudent investment in Wolf Creek will not be subject to regulatory review at any time in the future should unexpected contingencies occur in either KG&E's proposed Plan or its operations. As pointed out by KG&E in its Application, any changes or modifications to the operation of this Plan or any other increase in rates cannot be implemented without prior Commission approval.

47. It must be emphasized that our approval of KG&E's Plan is premised on no rate increases other than

those set forth above. This is particularly true of the cost of service treatment afforded Wolf Creek costs but includes all the various accounting and ratemaking elements of the plan. Although we find these requests reasonable as part of KG&E's effort to improve its financial situation without further rate increases, reconsideration of all the elements would be necessary in the event of any request to increase rates. Furthermore, in such an event, it would be incumbent on KG&E to prove the reasonableness of all elements of its cost of service. Of course, the Commission also continues to have the right to reexamine all elements of KG&E's revenue requirements should it appear that its earnings or rates are unreasonably high.

IT IS, THEREFORE, BY THE COMMISSION ORDERED AND ADJUDGED THAT:

1. KG&E is permitted to combine $800 million of its projected stream of income in excess of premium expense from corporate owned and shareholder funded life insurance with utility operating revenue to cover its Kansas jurisdictional cost of service. This cost of service includes a return on KG&E's prudent investment in Wolf Creek.

2. KG&E is permitted to:

(a) Delay from September 27, 1987, to January 1, 1989, the third increase approved in the Wolf Creek rate Orders and will add to such increase any revenue impacts resulting from the Commission finding in Docket No. 142,098-U regarding retirement of its Ripley Station.

(b) Delay from September 27, 1988, to January 1, 1992, the fourth increase approved in the Wolf Creek rate Orders.

(c) Spread the third and fourth increases on an equal percentage basis to each component of each schedule.

(d) The third and fourth increases are to be permanent and spread on an equal percentage basis to each component of each rate schedule.

3. KG&E is authorized to reduced its current rate for residential and farm electrical space heating customers for usage which exceeds 650 KWHs per month and for all-electric apartments, 500 KWHs per month, during the non-summer months from 7.14¢ per KWH to 5¢ per KWH.

4. KG&E is required to report in writing to the Commission and staff, by December 15 of each year; (1) KG&E's existing load management capability; (2) the anticipated addition to that capability for the next year; (3) the current corporate goal, with an explanation of why it is less than 100 MW, or why it cannot be higher than 100 MW; (4) a listing of promotional/educational efforts in the past year by KG&E to let customers know the details of the load management program, as well as an update on how those efforts will be increased or perfected in the coming year; (5) the amount by which the previous year's summer peak demand was reduced through utilization of the company's load management program; (6) the estimated in-service date and estimated capacity of new plant additions over the next 10 years, and; (7) a copy of the economic analysis supporting the type of generation favored versus the reasonably available alternatives. In addition, the company shall submit by June 1 of each respective year the Load and Capability Forecast for that year.

5. KG&E is permitted to retain the benefits of cost cutting measures, economic refinancings and the new federal tax law. If during the period 1987 through 1991 KG&E's actual increases in operating income due to the benefits of the Tax Reform Act of 1986 exceed those levels found in Exhibit 1, Schedule EDP-6, the excess shall be subject to investigation and refund if circumstances warrant. KG&E is directed to file a report with

the Commission by April 1 of each year through 1992 which shows the increase to its previous year's operating income which results from the benefits of the Tax Reform Act of 1986 when compared to the previous tax law. Such report shall be calculated and presented as requested by staff.

6. Docket No. 149,109-U is consolidated with this Docket.

7. The authority granted to KG&E in Docket No. 149,109-U to accelerate to eight years the amortization of construction related tax credits, as more fully described in that Docket, is reaffirmed.

8. KG&E is permitted to accrue carrying charges on the portion of Wolf Creek which the Commission finds constitutes excess physical capacity. Such accrual will be at KG&E's before tax (gross) cost of debt and preferred stock adjusted annually and shall be applied to KG&E's investment of $2,376 per KWH.

9. KG&E is permitted to accrue deferred phase-in revenues at a before tax (gross) rate until the delayed third rate increase becomes effective on January 1, 1989. KG&E is also permitted to accrue carrying charges on these accumulated revenues until the delayed fourth rate increase becomes effective on January 1, 1992. The carrying charges are to be based on a 15.5 percent cost of equity and KG&E's actual cost of debt and preferred stock adjusted annually. These carrying charges are to be compounded seminannually. KG&E is not permitted to accrue deferred phase-in revenue related to the incremental impact of Ripley's retirement.

10. KG&E is permitted to cease accrual of all deferrals and carrying charges on December 31, 1991, and thereafter amortize the deferrals and carrying charges on a sinking fund basis over Wolf Creek's remaining depreciable life.

11. KG&E is permitted to extend Wolf Creek's depreciable life to 40 years and to establish a composite annual depreciation rate of 2.61 percent for its share of Wolf Creek.

12. KG&E's previous Application requesting that interim charges for electric service be made permanent in this Docket is approved.

13. KG&E is permitted to amortize over the next five years the deferred asset of $6.4 million representing the allowed cost of operating Wolf Creek during the period beginning with the commercial service date and ending with the effective date of the Wolf Creek rate Orders.

14. Under the methodology of the Wolf Creek rate Orders, KG&E's excess physical capacity in Wolf Creek is 269 MW. Beginning January 1, 1988, such excess shall be reduced consistent with the findings of this Order.

15. KG&E will be permitted to amortize the undepreciated portion of the $128 million of its investment in Wolf Creek previously determined by this Commission to be imprudent. The amortization period will be Wolf Creek's remaining depreciable life.

16. KG&E's plan permits rate recognition of KG&E's investment in Wolf Creek beginning January 1, 1992.

BY THE COMMISSION IT IS SO ORDERED.

Lennen, Chm.; Wright, Com.; Henley, Com.

Dated: March 11, 1987

/s/ Judith McConnell
JUDITH MCCONNELL

SEAL

Order Mailed Mar. 11, 1987

RLB:rh

APPENDIX G

Motion by the Kansas Corporation Commission to Dismiss Kansas Gas and Electric Company for Lack of a Case or Controversy (April 13, 1987)

Nos. 86-781 and 86-793

IN THE SUPREME COURT
OF THE UNITED STATES
OCTOBER TERM, 1986

KANSAS GAS AND ELECTRIC COMPANY,
Appellant,

vs.

STATE CORPORATION COMMISSION OF THE STATE OF KANSAS,
Appellee.

KANSAS CITY POWER AND LIGHT COMPANY,
Appellant,

vs.

STATE CORPORATION COMMISSION OF THE STATE OF KANSAS,
Appellee.

ON APPEAL FROM THE SUPREME COURT OF KANSAS

MOTION BY THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS TO DISMISS KANSAS GAS AND ELECTRIC COMPANY FOR LACK OF A CASE OR CONTROVERSY

Pursuant to Rule 42 of the Rules of the United States Supreme Court, Appellee State Corporation Commission of the State of Kansas (KCC or Commission) respectfully moves this Court to dismiss Case No. 86-781, the appeal of Kansas Gas and Electric Company (KG&E), for mootness, or a lack of a case or controversy.

STATEMENT OF THE CASE

This matter involves consolidated appeals by Kansas City Power and Light Company (KCPL) and the Kansas Gas and Electric Company from orders of the State Corporation Commission of the State of Kansas concerning interim rates associated with Kansas' first nuclear generating station, Wolf Creek. The Kansas Supreme Court affirmed the Commission's orders in *Kansas Gas and Electric Co. v. Kansas Corporation Commission*, 239 Kan. 483, 720 P.2d 1063 (1986), reh'g denied, July 17, 1986. The United States Supreme Court noted probable jurisdiction on February 23, 1987.

ARGUMENT AND AUTHORITIES

It is well settled that federal courts may act only in the context of a justiciable case or controversy. *Benton v. Maryland*, 395 U.S. 784, 788 (1969). The lack of jurisdiction to review moot cases derives from the requirement of Article III of the Constitution under which the exercise of judicial power depends upon the existence of a case or controversy. *Liner v. Jafco, Inc.*, 375 U.S. 301, 306 n.3 (1964). Indeed, a controversy must exist

at all stages of appellate review, and not merely at the beginning of the action. *S.E.C. v. Medical Committee for Human Rights*, 404 U.S. 403 (1972). No such justiciable controversy now exists as to KG&E's appeal because recent developments before the KCC have substantially altered the relevant facts.

In its appeal to this Court, KG&E alleges the 1985 Wolf Creek rate orders violated its constitutional rights by setting confiscatorily low rates and denying it equal protection and due process of law. However, the 1985 Wolf Creek order was interim in nature. It was well understood by all parties that a permanent rate case would be heard subsequently. In the case of Appellant KG&E, a permanent rate proceeding was held and the attached order issued. KG&E neither requested rehearing nor appealed the order, and with good reason. The current order granted virtually all that it requested. (KG&E Jurisdictional Statement, p. i) Thus, KG&E's rates are not based on the 1985 order, which was interim in nature, but rather on an order issued by the Commission on March 11, 1987.[1] The recent "permanent" order has results which allow substantial improvements in KG&E's finances, delays previously authorized rate increases and reduces the space heating rate, all as requested by KG&E. Significantly, that order also provides for a 5 year phase-in of the Wolf Creek physical excess capacity and amortization of the costs previously found imprudent. (Appendix, p. A26, ¶ 41, p. A31, ¶ 44) Furthermore, the March 11th order contains a valuation of the Wolf Creek plant at its full "prudent" original cost rather than the valuation method forming the basis for KG&E's equal protection and due process contentions. Consequently, there is no legal or factual basis for appeal of the original interim order since any review by this Court would have no effect on KG&E's rates or earn-

[1] Order in Docket Nos. 142,098-U and 149,109-U attached as Appendix.

ings. Significantly, KG&E's witness in the permanent rate proceeding reached the same conclusion when he maintained that the Wolf Creek appeal in this court would not change nor alter the strategy of KG&E in reestablishing its financial health. (Transcript attached as Appendix)

As is customarily true of initial changes in rates due to completion of large electric generating plants, the original Wolf Creek orders were interim in nature.[2] Because those interim rates were based upon estimated data, permanent rates were not to be established until six months of historical data was gathered from the operation of Wolf Creek. However, in addition to requesting that its rates be made permanent, KG&E on December 9, 1986, requested Commission approval of a "rate stabilization overall plan" consisting of a number of interrelated accounting, financing and rate elements which it believed would benefit both ratepayers and investors.

In its rate stabilization plan KG&E urged the Commission to (a) revalue Wolf Creek at $2,376.00 per KW; (b) approve a mechanism which would allow all of Wolf Creek capacity to be recognized in rates by 1992; (c) delay approximately $80 million in rate increases already approved by the Commission;[3] and (d)

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[2] Interim rates are rates subject to change or adjustment. Traditionally the adjustments are performed in the next permanent rate case. The Commission's rationale for making KG&E's rates interim is found in the Joint Appendix, p. 122c-123c.

[3] In the initial case concerning Wolf Creek, KG&E, as well as a number of intervenors and staff, proposed a variety of phase-in plans. The Commission ultimately adopted a four step, nine year phase-in, which had interim rate increases due on September 27, 1987, and September 27, 1988. The KG&E plan proposed delaying the September 1987 phase-in increase until January 1, 1989, and delaying the September 1988 increase until January 1, 1992. The revenue increases which KG&E would have received if the original phase-in were followed, and which will be foregone under the plan, amount to approximately $80 million. (Appendix, p. A17, ¶ 32)

lower, by approximately $6 million per year, the space heating rate currently on file with the Commission. In addition, KG&E requested various accounting changes and prospective rate findings. KG&E also requested Commission approval to purchase "key-man" life insurance, and dedicate an $800 million income stream generated by these insurance policies to Kansas jurisdictional cost of service.

With slight modifications, the Commission approved KG&E's plan on March 11, 1987. The permanent rates now in effect are, therefore, based upon the March 11th order, insofar as this appeal is concerned. The 1985 orders simply have no relevant legal effect on KG&E's current rates, having been superseded in all material respects by the March 11, 1987 order. Although the 1985 order made many determinations on various cost of service components, such as operation and maintenance expense and decommissioning costs, which are reflected in current rates, there is no dispute between the parties concerning the lawfulness or reasonableness of those findings. Rather, it is the 1985 treatment of Wolf Creek capital costs which is the focus of KG&E's appeal. That treatment, however, is no longer in effect. Thus, continued Court review of the 1985 Wolf Creek order would have no effect on KG&E's rates, and would not be in the interest of judicial economy.

It may be argued by Appellant that this case is not moot because it represents an issue capable of repetition, yet evading review. *Moore v. Ogilvie*, 394 U.S. 814 (1969); *Roe v. Wade*, 410 U.S. 113 (1973) Interim utility rate orders may sometimes be superseded by permanent rate orders before judicial review is completed. However, it is not necessary in this case to address generally the question of mootness in such situations. Clearly, this is not a a situation which is capable of repetition in the normal course of events. In this instance, the specific basis for each of the issues on appeal has been

completely changed by the subsequent order making rates permanent. Furthermore, the March 11, 1987 Commission order contemplates that the framework it establishes will govern the setting of KG&E rates for the remaining operational life of Wolf Creek.

As reflected in the March 11, 1987 order KG&E anticipates no future rate increases associated with Wolf Creek capital costs other than those provided for by the plan. (Appendix, p. A11, ¶ 23) This is because the plan allows for adequate future returns on KG&E's investment. Due to the accounting, ratemaking and other changes authorized by the Commission, KG&E projects that it will earn a return on equity in the next ten years which will range between 8.69 percent to 10.39 percent. (Appendix, p. A14, ¶ 26) This projection includes return on equity associated with Wolf Creek costs which the Commission found to be imprudently incurred. (KG&E is not appealing that Commission determination.) In conjunction with the fact that KG&E stock recently sold at $23.50 a share, a ten year high, and its expected 1986 dividends are $1.40 a share, it is thus evident why KG&E's plan requires no additional rate increases. (Appendix, p. A14, ¶ 26)

The preceding facts also demonstrate that the Commission's approval of KG&E's plan has rendered moot KG&E's contentions of confiscation. The end results of the balancing of investor and consumer interests required by *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944), were significantly different in the Commission's March 11th order than its 1985 orders. Under the March 11th order, KG&E investor interests were substantially benefitted—albeit without a major increase in rate.[4] Perhaps most telling to the con-

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[4] KG&E's plan seems to be based in large part on recognition that its rates are high and that the company's financial health is inextricably tied to making its electric service affordable and useful to consumers. (Appendix, p. A12, ¶ 24) Thus, the delays in scheduled

tinuing vitality of KG&E's *Hope* argument, however, is the fact that the rate levels now in effect and end results of those current rates are precisely those requested by KG&E. Quite simply, the balance achieved by current rates under KG&E's plan are evidently satisfactory to the company.

The legally operative facts relating to KG&E's equal protection and due process claims have also changed. Both those claims arise from the Commission's valuation of Wolf Creek in the 1985 order at $1290 per kilowatt of capacity. The March 11th order, however, changed that valuation of $2376 per KW. Since that new valuation represents Wolf Creek's original prudent cost, which KG&E argues is required by the equal protection clause there is no longer an issue on that claim. Further, since the new value of Wolf Creek is at the figure requested by KG&E, there is no longer any basis for KG&E's claim that it received inadequate notice in violation of its due process rights.

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rate increases and reduction in space heat rates are designed to avoid loss of customers.

CONCLUSION

KG&E's appeal to this Court is moot because the appeal was based upon an interim rate order, which has been superseded by the permanent rate order. In addition, every aspect of the original, interim order which KG&E alleges was constitutional infirm has now been changed in the permanent rate order to reach results which KG&E urged in its recent rate application. Consequently, no issue, case, or controversy exists between KG&E and the KCC.

Respectfully submitted,

BRIAN J. MOLINE
DONALD A. LOW
Special Counsel
EVA POWERS
Acting General Counsel
ROBERT L. BEZEK, JR.
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State Corporation Commission
Fourth Floor
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Topeka, Kansas 66612
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Attorney for Appellee

APPENDIX H

Federal Energy Regulatory Commission Acceptance of the Participation Power Agreement between Kansas Gas and Electric Company and Oklahoma Municipal Power Authority (August 12, 1986)

FEDERAL ENERGY REGULATORY COMMISSION
Washington, D.C. 20426

Aug. 12, 1986

Docket No. ER86-503-000

Kansas Gas and Electric Company
Attention: Mr. Ernest A. Lehman
Manager of Rates
P.O. Box 208
Wichita, Kansas 67201

Dear Mr. Lehman:

By letters dated May 22 and June 16, 1986, you submitted for filing with the Commission a participation power agreement with the Oklahoma Municipal Power Authority. Authority to act on this matter is delegated to the Director, Division of Electric Power Application Review, under Section 375.308 of the Commission's Regulations; pursuant to Section 375.308(a), your submittal is accepted for filing and designated as shown on the Enclosure.

Notice of your filing was published in the Federal Register with comments, protests, or interventions due on or before July 3, 1986. No comments, protests, or interventions were filed.

Good cause is shown for granting waiver of the notice requirements pursuant to Section 205(d) of the Federal Power Act and Section 35.11 of the Commission's Regulations thereunder; therefore, the rate schedule shall become effective July 1, 1986.

Please be advised that additional charges to OMPA pursuant to Section 13.5 of the Participation Power Agreement will require timely filing pursuant to Part 35 of the Commission's Regulations together with appropriate cost support.

This acceptance for filing does not constitute approval of any service, rate, charge, classification, or any rule, regulation, contract, or practice affecting such rate or service provided for in the filed documents; nor shall such acceptance be deemed as recognition of any claimed contractual right or obligation affecting or relating to such service or rate; and such acceptance is without prejudice to any findings or orders which have been or may hereafter be made by the Commission in any proceeding now pending or hereafter instituted by or against Kansas Gas and Electric Company.

This action is final unless a petition appealing it to the Commission is filed within 30 days from the date of this letter, as provided in Rule 1902 of the Commission's Rules of Practice and Procedure, 18 CFR 385.1902. The filing of a petition appealing this action to the Commission or an application for rehearing as provided in Section 313(a) of the Federal Power Act does not operate as a stay of any date specified in this letter except as specifically ordered by the Commission.

This acceptance for filing terminates Docket No. ER86-503-000.

Sincerely,

/s/ Jerry R. Milbourn
JERRY R. MILBOURN
Director
Division of Electric Power
Application Review

Enclosure

cc: Oklahoma Municipal Power Authority
Attention: Mr. Ronald Dawson
General Manager
2300 East Second Street
P.O. Box 1960
Edmond, Oklahoma 73083-1960

Enclosure

Kansas Gas and Electric Company
Docket No. ER86-503-000
Rate Schedule Designations

	Designation	Description
(1)	Rate Schedule FERC No. 162	Participation Power Agreement
(2)	Supplement No. 1 to Rate Schedule FERC No. 162	Transmission Agreement
(3)	Supplement No. 2 to Rate Schedule FERC No. 162	Supplemental Energy Agreement

APPENDIX I

Participation Power Agreement between Kansas Gas and Electric Company and Oklahoma Municipal Power Authority (May 22, 1986)

PARTICIPATION POWER AGREEMENT
BETWEEN
KANSAS GAS AND ELECTRIC COMPANY
AND
OKLAHOMA MUNICIPAL POWER AUTHORITY

THIS AGREEMENT, made as of this 22nd day of May, 1986, by and between KANSAS GAS AND ELECTRIC COMPANY, a public utility incorporated under the laws of the state of Kansas (hereinafter referred to as "KG&E"), and OKLAHOMA MUNICIPAL POWER AUTHORITY (hereinafter referred to as "OMPA"), a governmental agency of the state of Oklahoma and a body politic and corporate.

WITNESSETH:

WHEREAS, the parties desire to provide for the purchase and sale of participation power from Gordon Evans and Murray Gill Generating Stations (hereinafter referred to as Evans/Gill) for a fixed period of time from KG&E to OMPA.

NOW, THEREFORE, in consideration of the premises and of the covenants and agreements hereinafter set forth, the parties agree as follows:

Section 1—Participation Power Service

1.1 Participation Power Service as used herein shall mean electric power and accompanying energy made available by KG&E to OMPA from KG&E's gas/oil fired steam electric generating stations identified

as the Evans/Gill stations with nominal rated capacities of 515 MW and 324 MW respectively.

Section 2—Availability

2.1 KG&E agrees to make available, and OMPA agrees to pay for the following amount of capacity and accompanying energy as set forth below, all subject to the terms and conditions stated. A contract year shall be defined as June 1 through May 31 of the succeeding year.

Contract Year	MW Purchased	MW Delivered
1986	20.6	20.0
1987	30.9	30.0
1988-2000	41.2	40.0

2.2 The capacity available to OMPA is subject to reduction on a pro-rata basis if Evans/Gill is partially or totally unavailable and if Evans/Gill capacity is required to satisfy KG&E's system needs. Availability to OMPA shall be determined based on the following formulas:

A=B/C x D

Where:

A=OMPA's purchased entitlement

B=Available capability of Evans/Gill

C=Rated capacity of Evans/Gill

D=OMPA's purchased capacity.

Provided, however, that OMPA's capacity entitlement shall not be reduced or prorated if:

(a) KG&E places Evans/Gill unit(s) in retirement status and/or

(b) Outages at Evans/Gill are scheduled pursuant to KG&E's maintenance program.

2.3 KG&E shall use its best efforts to make Evans/Gill continuously available subject to emergency outages and outages for scheduled maintenance.

2.4 In the event a portion of the capacity to which OMPA has a capacity entitlement is unavailable pursuant to paragraph 2.2 above, KG&E shall, at OMPA's request, use its best effort to secure energy from the most economical resource available to KG&E and provide such energy to OMPA under service schedule SE or other appropriate service schedules which may be filed from time to time.

2.5 Delivery by KG&E of power for OMPA shall be made to KG&E's interconnections with Oklahoma Gas and Electric Company (OG&E) and Public Service Company of Oklahoma (PSO) in quantities specified by OMPA. Should KG&E effect a direct interconnection with Western Farmers Electric Co-operative or Southwestern Power Administration, then OMPA may also designate deliveries hereunder be made at those interconnections. Such deliveries shall be made pursuant to Service Schedule T Transmission Service.

Section 3—Charges for Service

3.1 OMPA shall pay to KG&E the following monthly charges for the Participation Power Service made available hereunder:

Capacity Charge

$2.50 per kW month of contracted capacity.

Energy Charge

An energy charge calculated on a monthly basis consisting of the energy associated costs of Evans/Gill during the billing period which charges consist

solely of fuel and other variable operating and maintenance expense as defined below.

(a) Fuel costs shall be estimated for the month in which service was provided. Any excess or deficiency from actual costs shall be reflected in the following month's bill.

(b) The other variable operating and maintenance expenses are limited to those costs recorded in accounts 510, 512 and 513 of the Federal Energy Regulatory Commission (FERC) Uniform System of Accounts. Such costs shall be determined by dividing the latest available 12 months total expense by the net kWh generated during the same period and applying the resulting cost per kWh to the kilowatthours scheduled by OMPA.

3.2 If OMPA is unable to effect transmission from KG&E to OMPA of all or a portion of the purchased capacity provided for in paragraph 2.1 hereof for more than 30 consecutive days, then to that extent and from the expiration of said 30 days there will be no charges for service hereunder. If such period of transmission interruption, attributable to a party other than KG&E or OMPA, continues for a subsequent consecutive 30-day period, KG&E may terminate this agreement upon 30 days written notice.

Section 4—Energy Scheduling

4.1 Subject to paragraph 4.2, OMPA may use energy from the capacity specified in paragraph 2.1 up to 100% load factor, subject to unit availability as discussed in paragraph 2.2. The maximum energy available in kilowatthours in any clock hour shall be the capacity specified in paragraph 2.1 times one hour.

4.2 OMPA shall take a minimum of 20% of the available delivered capacity at 100% load factor during the hours from 0801 Monday through 2000 hours Friday of each week set forth in KG&E's notification of designated hours; said notification shall be provided to OMPA annually by KG&E. The designated hours not to exceed fifteen (15) weeks annually will generally occur in the months of June, July, August and September each year.

4.3 All power and energy other than that power and energy scheduled during the designated hours shall be scheduled at least sixteen (16) hours in advance of delivery, or at such lesser time as determined by KG&E's dispatcher, through the dispatching offices at OG&E, PSO, or such other dispatching offices as may be agreed upon. During designated hours, such scheduling shall be upon eight (8) hours notice. At the time of scheduling, the KG&E dispatcher shall provide OMPA with an estimated energy cost. KG&E expressly disclaims any and all warranties concerning the accuracy of such estimates. Billing by KG&E shall be based upon the provisions of paragraph 3.1 hereof.

Section 5—Payment of Charges

5.1 Invoices for any month shall be rendered by KG&E on or before the tenth (10th) day of the following month, and shall be paid by OMPA before the twenty-fifth (25) day of said following month or fifteen (15) days after receipt of the invoice, whichever is later.

Section 6—Term

6.1 This Agreement shall become effective on the later of the following dates:

(a) July 1, 1986; or

(b) The effective date requested by the parties in the filing of this document with FERC unless a later date is ordered by FERC;

or

(c) The date OMPA has legally effective transmission contracts and schedules with OG&E.

6.2 This Agreement shall continue in full force and effect until December 31, 2000, as which time it shall automatically terminate unless extended by mutual agreement.

Section 7—Supplemental Energy Availability

7.1 Based upon various factors, including KG&E's capacity situation and load projections, KG&E's dispatchers will provide a 48-hour forecast of supplemental energy availability and price range each day to OMPA's dispatchers for their consideration. In the event KG&E is unable to supply supplemental energy for reasons other than set out in Service Schedule SE during the initial four (4) years of the Agreement, OMPA, in its sole discretion, may withdraw from the Agreement and related Service Schedules in its entirety upon 90 days written notice to KG&E. KG&E shall be deemed unable to supply supplemental energy when it fails to offer the contract capacity specified in paragraph 2.1 in MWH per hour for twelve (12) consecutive hours more than ten (10) times in any one calendar year except that the months of June, July, August and September shall not be considered as months included in said ten (10) occurrences.

Section 8—Liability

8.1 Each party shall defend, indemnify and save harmless the other party from and against any and all

claims or liability for injury or damage to persons or property, including any related loss, cost or expense, caused by or resulting from the construction, installation, operation or maintenance of any of the electric facilities owned, operated or maintained by the indemnifying party or by reason of the acts of negligence or willful misconduct of its agents, servants or employees in connection therewith.

Section 9—Uncontrollable Forces

9.1 Neither party shall be considered to be in default in respect of any obligation hereunder if prevented from fulfilling such obligation by reason of uncontrollable forces. The term "uncontrollable forces" shall be deemed for the purposes hereof to include among others such causes as storm, flood, lightning, earthquake, fire, explosion, failure of apparatus or equipment, accident damaging facilities upon which performance is dependent, failure of manufacturers to make scheduled deliveries of equipment, act of the public enemy, sabotage, civil disturbance, labor disturbance, strike, impact of war or mobilization, national emergency, order by court or by public authority, or other causes beyond the control of the party affected, which such party could not reasonably have been expected to avoid by exercise of due diligence and foresight and by provision of reserve facilities in accordance with good practice. Either party unable to fulfill any obligation by reason of uncontrollable forces shall exercise due diligence to remove such disability, if practicable, with reasonable dispatch except that any labor disturbance may be settled at the discretion of the party affected thereby.

Section 10—Termination on Default

10.1 Should either of the parties hereto violate any material provision of this Agreement, the other party

may terminate this Agreement by giving thirty (30) days prior written notice of its intention to do so, but any other remedy or remedies available under the law for such violation shall not be limited in any way because of this provision or the exercise of the right conferred hereunder.

Section 11—Waivers

11.1 Any waiver at any time by either party of its rights with respect to a default under this Agreement, or with respect to any other matter arising in connection with this Agreement, shall not be deemed a waiver with respect to any subsequent default or matter. Any delay short of the statutory period of limitation in asserting or enforcing any right shall not be deemed a waiver of such right.

Section 12—Audit Rights

12.1 During the life of this Agreement, OMPA, or its representatives, shall have the right to examine KG&E's applicable books, records and underlying source documentation. Said examinations shall be scheduled with KG&E during normal business hours.

Section 13—Commission Approval

13.1 This Agreement and all obligations hereunder are conditioned upon the granting of any requisite approval and authority by the Federal Energy Regulatory Commission and/or any other regulatory body whose approval or authorization may be required by law.

13.2 In the event any regulatory authority having jurisdiction should not approve any provision of this Agreement, it is agreed that either party may terminate the Agreement.

13.3 The rates, terms, and conditions for service specified herein shall remain in effect for the term of this Agreement, and shall not be subject to change through application to the Federal Energy Regulatory Commission pursuant to the provisions of Section 205 of the Federal Power Act absent the agreement of all parties thereto.

13.4 Paragraph 13.3 is applicable to the rates, terms and conditions of this Participation Power Agreement only and shall not effect any other service schedule(s) which may be filed in conjunction with said Participation Power Agreement.

13.5 Should KG&E be required, during the term of this Agreement, to make capital expenditures for the restriction and/or control of the emission of pollutants, the capacity charge may be adjusted to reflect the increased investment. Provided, however, that if in OMPA's sole judgment, the capacity charge adjustment renders the purchase and sale hereunder no longer economic, OMPA may terminate this Agreement on thirty (30) days written notice. Such notice shall be rendered to KG&E within ninety (90) days of receipt of written notice from KG&E of the amount and basis of the capacity charge adjustment.

Adjustments of the capacity charge shall include only KG&E's capital investment. Any other components of the charge shall be adjusted only by mutual agreement.

Section 14—Assignment

14.1 This Agreement shall inure to the benefit of and be binding upon the successors and assigns of the respective parties.

Executed as of the date first hereinabove mentioned.

KANSAS GAS AND ELECTRIC COMPANY

ATTEST:

/s/ [Illegible]
Secretary

By /s/ R. M. Haden
Group Vice President

[SEAL]

OKLAHOMA MUNICIPAL POWER AUTHORITY

ATTEST:

/s/ [Illegible]
Secretary

By /s/ Michael D. Brown
Chairman

[SEAL]

SERVICE SCHEDULE T

TRANSMISSION SERVICE

This Service Schedule T is agreed to be effective on the same date and as a part of and under that certain Participation Power Agreement (Agreement) dated May 22, 1986 by and between Kansas Gas and Electric Company ("KG&E") and the Oklahoma Municipal Power Authority ("OMPA"). It shall apply to said parties for the purposes and in the manner as set forth in this Service Schedule T.

Section 1—Transmission Service

1.1 Transmission Service, as used herein, shall mean firm electric transmission capacity held in readiness and made available by KG&E for OMPA on a prearranged basis for the purpose of transmitting OMPA's electric capacity and energy to designated Delivery Points as set out in paragraph 2.5 of the Agreement. Said Transmission Service shall include the operation of KG&E facilities so that in the event the electric transmission capacity is unavailable for any reason, KG&E shall use due diligence to restore said transmission capacity. For curtailment purposes, OMPA will be treated on a non-discriminatory basis vis-a-vis all other firm customers of KG&E.

Section 2—Availability

2.1 OMPA shall advise KG&E in writing by a Letter of Intent of its transmission capacity requirements for each Delivery Point pursuant to this Service Schedule. Both parties agree the amount of transmission capacity of Delivery Point specified in said Letter of Intent will be reserved for sole use by OMPA during the period specified in the Letter of Intent and that said capacity be in an amount equal to the "Purchased" column of paragraph 2.1 of the Agreement.

2.2 The initial Letter of Intent will cover the period May 31, 1987. By April 1, 1987 and by the same date each year thereafter, OMPA shall provide KG&E with a new Letter of Intent for the next contract year of June 1 through the succeeding May 31. OMPA may revise its Letter of Intent from time to time.

2.3 OMPA transmission capacity requirements in the Letter of Intent, shall be expressed as the estimated maximum one (1) hour kilowatt requirement for each Delivery Point for the contract year and shall be equal to purchased capacity as set forth in paragraph 2.1 of the Agreement except by mutual agreement.

2.4 OMPA agrees to pay for the contracted transmission capacity as set forth in Section 3, Payment for Transmission Service, of this schedule.

Section 3—Payment for Transmission Service

3.1 For Transmission Service supplied under this Service Schedule as set out in Section 2, OMPA shall compensate KG&E at the following monthly rate:

$1.264 per kilowatt per month of contracted transmission capacity plus an amount for losses calculated as follows:

A=B x C x D, where:

A=Amount to be billed for losses

B=Energy in kWh delivered pursuant to the Participation Power Agreement

C=The transmission loss factor of 3%

D=Average system fuel cost and purchased power cost as determined on a monthly basis.

Section 4—Other Provisions

4.1 KG&E and OMPA's performance under this Service Schedule is subject to the approval of the Federal Energy Reglatory Commission (FERC) or any other such regulatory bodies as may have jurisdiction in this matter. Further, if the terms and conditions agreeable to both parties are not approved by the regulatory bodies having jurisdiction, this Service Schedule shall not be binding upon either party.

4.2 Nothing contained herein shall be construed as affecting, in any way, the right of the party furnishing service under this rate schedule to unilaterally make application to the Federal Energy Regulatory Commission for a change in rates under Section 205 of the Federal Power Act and pursuant to the Commission's Rules and Regulations promulgated thereunder.

Section 5—Term

5.1 This Service Schedule T shall become effective on the date hereof, and shall continue for the same period and concurrent with the Participation Power Agreement of which this Service Schedule T is a part.

Executed as of the date hereinabove written.

ATTEST:	KANSAS GAS AND ELECTRIC COMPANY
/s/ [Illegible] Secretary	By /s/ R. M. Haden Group Vice President
[SEAL]	
ATTEST:	OKLAHOMA MUNICIPAL POWER AUTHORITY
/s/ [Illegible] Secretary	By /s/ Michael D. Brown Chairman
[SEAL]	

SERVICE SCHEDULE SE

SUPPLEMENTAL ENERGY

This Service Schedule SE is agreed to be effective on the same date and as a part of and under that certain Participation Power Agreement dated May 22, 1986 by and between Kansas Gas and Electric Company ("KG&E") and the Oklahoma Municipal Power Authority ("OMPA"). It shall apply to said parties for the purposes and in the manner as set forth in this Service Schedule SE.

Section 1—Supplemental Energy

1.1 Supplemental Energy, as used herein, shall mean electric energy from units which at the time can supply surplus energy not required by KG&E for its control area load, or can be obtained and delivered by KG&E at a cost which is lower than the cost OMPA would incur by producing such energy.

Section 2—Availability

2.1 The amount of KG&E's system capacity which is available to provide service hereunder will vary and may be limited from time to time depending upon KG&E's system loads and other operating conditions.

2.2 Supplemental Energy is available to OMPA only to the extent that such party has alternate dependable capacity available at the time of the purchase which could otherwise be used.

2.3 Arrangements for Supplemental Energy service shall be made by the dispatchers prior to sixteen hundred (1600) hours of the day preceding the proposed transaction or at other times as may be mutually agreed upon. If the parties mutually agree to purchase and sell Supplemental Energy, then KG&E shall furnish the agreed amount of Supplemental Energy at the quoted price from any source available to it except that parties agree energy delivered

pursuant to paragraph 3.1(b) shall be based on KG&E's cost. However, if an emergency as determined by KG&E should occur on KG&E's system, OMPA agrees that it will relieve KG&E of its obligation to supply such Supplemental Energy.

Section 3—Payment for Supplemental Energy

3.1 OMPA shall compensate KG&E monthly for all energy delivered under this Service Schedule at the following rate:

(a) Energy generated by KG&E:

During on-peak hours: The incremental production cost per kWh during the transaction plus 3.0 mills per kWh.

During off-peak hours: The incremental production cost per kWh during the transaction plus 2.0 mills per kWh.

(b) When OMPA requests and KG&E purchases from another source, OMPA shall pay for kilowatthours delivered under the following formula:

KG&E's cost to procure such power and energy from another source,

plus

KG&E's cost to generate transmission losses calculated as follows:

(i) incremental fuel cost

(ii) most current 12-month ended production, operation and maintenance expenses, other than Account 501, fuel

(iii) 10% of items (i) and (ii) but the 10% amount shall not exceed two (2) mills.

The summation of items (i), (ii) and (iii) expressed in mills per kWh, times the kilowatt-hours of incremental transmission losses which shall be calculated at three (3) percent.

3.2 For purposes of this Schedule SE, the following definitions shall be applicable through May 31, 1989:

(a) "Off-peak" shall be all hours other than those defined in paragraph 3.2(b) below.

(b) "On-peak" shall be that period of time between six hundred one (0601) hours and twenty-two hundred (2200) hours of the same day during the months of June, July, August and September except Sundays and holidays as listed in paragraph 3.4.

3.3 Beginning June 1, 1989, for purposes of this Schedule SE, the following definitions shall be applicable:

(a) "Off-peak" shall be that period of time between twenty-two hundred one (2201) hours of one day and six hundred (0600) hours of the following day, and all day Sundays and holidays as listed in paragraph 3.4.

(b) "On-peak" shall be that period of time between six hundred one (0601) hours and twenty-two hundred (2200) hours of the same day except Sundays and holidays as listed in paragraph 3.4.

3.4 For the purpose of this Schedule, holidays shall be:

New Years Day	Labor Day
Memorial Day	Thanksgiving Day
Independence Day	Christmas Day

Section 4—Change in Rates

4.1 Nothing contained herein shall be construed as affecting in any way the right of the party furnishing service under this rate schedule to unilaterally make

application to the Federal Energy Regulatory Commission for a change in rates under Section 205 of the Federal Power Act and pursuant to the Commission's Rules and Regulations promulgated thereunder.

Section 5—Term

5.1 This Service Schedule SE shall become effective on the date hereof, and shall continue for the same period as and concurrent with the Participation Power Agreement of which this Service Schedule SE is a part.

Executed as of the date hereinabove written.

KANSAS GAS AND ELECTRIC COMPANY

ATTEST:

/s/ [Illegible]
Secretary

[SEAL]

By /s/ R. M. Haden
Group Vice President

OKLAHOMA MUNICIPAL POWER AUTHORITY

ATTEST:

/s/ [Illegible]
Secretary

[SEAL]

By /s/ Michael D. Brown
Chairman

APPENDIX J

Excerpts from the Federal Power Act, 16 U.S.C. §§ 824-824e

Section 201, 16 U.S.C. § 824:

Declaration of policy; application of subchapter

(a) Federal regulation of transmission and sale of electric energy

It is declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of matters relating to generation to the extent provided in this subchapter and subchapter III of this chapter and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States.

(b) Use or sale of electric energy in interstate commerce

(1) The provisions of this subchapter shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce, but except as provided in paragraph (2) shall not apply to any other sale of electric energy or deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line. The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction, except as specifically provided in this subchapter and subchapter III of this chapter, over fa-

cilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.

(2) The provisions of sections 824i, 824j, and 824k of this title shall apply to the entities described in such provisions, and such entities shall be subject to the jurisdiction of the Commission for purposes of carrying out such provisions and for purposes of applying the enforcement authorities of this chapter with respect to such provisions. Compliance with any order of the Commission under the provisions of section 824i or 824j of this title, shall not make an electric utility or other entity subject to the jurisdiction of the Commission for any purposes other than the purposes specified in the preceding sentence.

(c) Electric energy in interstate commerce

For the purpose of this subchapter, electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof; but only insofar as such transmission takes place within the United States.

(d) "Sale of electric energy at wholesale" defined

The term "sale of electric energy at wholesale" when used in this subchapter, means a sale of electric energy to any person for resale.

* * * *

Section 205, 16 U.S.C. § 824d:

Rates and charges; schedules; suspension of new rates; automatic adjustment clauses

(a) Just and reasonable rates

All rates and charges made, demanded, or received by any public utility for or in connection with the transmis-

sion or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) Preference or advantage unlawful

No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Schedules

Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Notice required for rate changes

Unless the Commision otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after sixty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly

the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the sixty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

Section 206, 16 U.S.C. § 824e:

Power of Commission to fix rates and charges; determination of cost of production or transmission

(a) Unjust or preferential rates, etc.; statement of reasons for changes; hearing; specification of issues

Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. Any complaint or motion of the Commission to initiate a proceeding under this section shall state the change or changes to be made in the rate, charge, classification, rule, regulation, practice, or contract then in force, and the reasons for any proposed change or changes therein. If, after review of any motion or complaint and answer, the Commission shall decide to hold a hearing, it shall fix by order the time and place of such hearing and shall specify the issues to be adjudicated.

* * * *

(d) Investigation of costs

The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.

(e) Suspension of new rates; hearings; five month period

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service shall go into effect at the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase,

specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require such public utility or public utilities to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

(3)

No. 90-984

In The

Supreme Court of the United States

October Term, 1990

Kansas Gas and Electric Company,
Petitioner,

v.

State Corporation Commission
of the State of Kansas, *et al.*
Respondents.

Petition for a Writ of Certiorari to the Court of Appeals of the State of Kansas

BRIEF IN OPPOSITION OF RESPONDENT CITIZENS' UTILITY RATEPAYERS BOARD

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QUESTION PRESENTED

Under the Federal Power Act, a dual system of regulation exists. The Federal Energy Regulatory Commission (FERC) regulates most of the wholesale transactions of electric utilities engaged in interstate commerce, and the regulation of retail electric rates is left largely to the states. The question presented by this case is:

> Whether the Kansas Corporation Commission acted within its jurisdictional authority in protecting captive retail ratepayers from some of the detrimental impacts associated with Petitioner's attempts to include additional generating capacity in its retail rates.

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IN THE

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STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, et al.,
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Petition for a Writ of Certiorari to the Court of Appeals of the State of Kansas

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BRIEF IN OPPOSITION OF RESPONDENT CITIZENS' UTILITY RATEPAYERS BOARD

Respondent Citizens' Utility Ratepayers Board (CURB)[1] respectfully prays the Court deny the Petition for a Writ of Certiorari requested by the Kansas Gas and Electric Company (KG&E) in this case.

STATEMENT OF THE CASE

This brief will describe in some detail the factual and

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[1] CURB is a state agency composed of five volunteer consumer advocate members. Through its attorney, the state's Consumer Counsel, CURB is authorized by state statute to represent the interests of residential and small commercial ratepayers. Kan. Stat. Ann. 66-1222 et seq. (1989).

procedural background of this case. Such detailed background is necessary because the agency decision being contested here was taken in response to a unique set of facts and a unique procedural history. In recognizing the fact-bound nature of that action, the Kansas Corporation Commission (KCC) stated, "It must be noted that this adjustment, which may be considered novel in terms of this Commission, is being made because of the novel circumstances in this docket." (KG&E App. 57a-58a). The Court may notice that, in contrast to this brief, KG&E's petition provides relatively little insight into the convoluted facts and procedural history of this particular case. This is because the nature of the case below, the issue being contested, and the KCC's treatment of that issue are, in reality, very different than portrayed in KG&E's petition.

KG&E's petition relates, at length, the development of federal jurisdiction concerning interstate wholesale power transactions. It paints a picture of a struggle for jurisdictional authority between federal and state regulators, and it argues that the Court must consider this case in order to help resolve that struggle. CURB does not disagree that the dual regulation of electric utilities creates tensions that the courts must address from time to time. However, this case, because of its unique facts and procedural background, is not the case on which to base the extension of federal jurisdictional authority requested by KG&E.

FACTUAL BACKGROUND

In 1985, after months of technical and public hearings, the KCC entered its order in the Wolf Creek rate case -- the case in which KG&E sought to place in rate base its share of the $3.05 billion Wolf Creek Nuclear Generating Station. In that order, in addition to authorizing

a phased-in rate increase, the KCC deemed one-half (46 megawatts [MW]) of the retired Ripley Steam Electric Station (Ripley) available for use until such time as the retirement was judged to be prudent by the Commission. The KCC deferred its decision regarding the rate implications of the Ripley retirement. *Re Wolf Creek Nuclear Generating Facility*, 70 P.U.R. 4th 475, 514 (Kan.Corp.Comm. 1985).

The Kansas Supreme Court affirmed that order in *Kansas Gas & Electric Co. v. Kansas Corporation Comm'n*, 239 Kan. 483, 720 P.2d 1063 (1986). KG&E appealed to this Court, which noted probable jurisdiction. *Kansas Gas & Elec. Co. v. State Corp. Comm'n of Kansas*, 479 U.S. 1082 (1987). The appeal subsequently was dismissed as moot. 481 U.S. 1044 (1987).

The KCC approved the retirement of Ripley by an order dated March 19, 1987. A few days earlier, by an order dated March 11, 1987, the Commission delayed a scheduled Wolf Creek increase from September 27, 1987 to January 1, 1989 and directed "that the revenue impact resulting from the Ripley retirement be added to the third increase and become effective on a permanent basis on January 1, 1989, with one condition." (KG&E App. 134a). That condition was that KG&E demonstrate that its "need for Wolf Creek, whether from peak growth or reduced overall generating capability, will have grown by 41 MW from 1986 to 1988 so as to justify adding the incremental revenue impact to the January 1, 1989, increase." (Id., 134a-135a). The amount of the "revenue impact" was not discussed in the order. The Commission also left the door open for further review of the future rate increase:

> However, we note by this action that we have not foreclosed the possibility of further challenge to the third and fourth increases. Nor is our action incon-

> sistent with the possibility that at some point after the increases become effective that it would be appropriate to examine the reasonableness of KG&E's earnings. . . . If no earlier action is necessary, any customer of KG&E, as well as the Commission staff, is always free to file a complaint alleging that KG&E's rates are unreasonable. (Id., 136a-137a).

The order further stated, "Of course, the Commission also continues to have the right to reexamine all elements of KG&E's revenue requirements should it appear that its earnings or rates are unreasonably high." (Id., 150a).

In a July 15, 1988, order, the revenue impact associated with the Ripley retirement was referred to by the Commission majority as "an opportunity (for KG&E) to demonstrate its need for an additional increase." Although the amount of the increase was not specified, one could infer from the order that the increase would amount to $14.4 million. This was the first time that the magnitude of the possible increase had been publicly disclosed. No hearings were held in the docket that produced that order.

The Commission conducted a hearing on December 21, 1988, to provide KG&E with an opportunity to prove that its need for additional generating capacity had increased by 41 MW from 1986 through 1988. The scope of that hearing was "strictly limited" to that issue by the Commission. Accordingly, neither in the prefiled testimony of the witnesses, nor during the hearing itself, was there any discussion of the rate increase that would occur if the 41 MW were to be included in rates.

CURB intervened in the case. Because of the short procedural schedule and the narrow scope of the hearing, as established by the Commission, CURB also moved the Commission to schedule further hearings to address numerous legal and factual issues raised by CURB and, in

the meantime, to grant KG&E its $14.4 million rate increase only on an interim basis, subject to refund.

On December 30, 1988, the Commission majority granted CURB's motion, and the $14.4 million increase was approved on an interim basis, subject to refund,[2] pending a KCC staff audit and further hearings. A $14.6 million increase, which represented the final Wolf Creek increase, was not contested and was granted to KG&E on a permanent basis by the order.

The KCC Proceedings at Issue

At the conclusion of its audit, the KCC staff filed testimony recommending that current rate levels (which included the recently-authorized $14.4 million rate increase) remain in effect. KG&E filed testimony making the same recommendation. CURB, on the other hand, filed testimony recommending numerous adjustments to KG&E's retail revenue requirement that, if adopted in their entirety, would result in a $32.9 million rate decrease. Two of the CURB adjustments that were adopted by the KCC were based upon KG&E's attempts to justify its need for additional generating capacity in its retail rate base. One of those two adjustments is the subject matter of KG&E's petition to this Court and will be discussed in detail later in this brief.

The KCC conducted both evidentiary hearings and public hearings, which provided an opportunity for input from KG&E retail ratepayers. On February 13, 1990, the KCC reduced KG&E's existing rate levels by about $8.7 million. That reduction incorporated the CURB-proposed adjustment related to the OMPA sale.

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[2] That part of the December 30, 1988 KCC order that designated the rate increase interim and subject to refund was later reversed by the Kansas Court of Appeals in an unpublished opinion.

The Kansas Court of Appeals Decision

KG&E appealed the KCC order to the Kansas Court of Appeals on April 2, 1990, arguing that the KCC had erred in adopting numerous adjustments proposed by its staff and by CURB. With regard to the adjustment related to the OMPA sale, KG&E argued that, under the Supremacy Clause, the KCC was preempted from considering the OMPA sale because the rate for the sale had been found to be reasonable by FERC. KG&E based its argument on the cases of *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953 (1986) and *Mississippi Power v. Miss. Ex Rel. Moore*, 487 U.S. 354 (1988).

The Kansas Court of Appeals, with one minor exception, affirmed all aspects of the KCC's order in an unpublished opinion dated June 29, 1990. It refused to extend the *Nantahala Power and Light Co.*and *Mississippi Power* holdings to the unique facts of this case. KG&E petitioned the Kansas Supreme Court to review the Kansas Court of Appeals decision. Again, KG&E raised numerous alleged points of error, one of which was the adjustment related to the OMPA sale. The Kansas Supreme Court denied KG&E's petition on September 20, 1990.

REASONS FOR DENYING PETITIONER'S WRIT

I. THIS CASE DOES NOT INVOLVE A CONFLICT BETWEEN FEDERAL AND STATE AUTHORITY REGARDING A WHOLESALE POWER TRANSACTION

As previously described at page three of this brief, the KCC's precondition for allowing the final 41 MW of Wolf Creek into KG&E's rate base was a showing by the Company that a "need" for that additional capacity had developed between 1986 and 1988. That "need" could result from "peak growth or reduced overall generating capability." (KG&E App. 134a-135a). The Commission, in December, 1988, found that KG&E had made a sufficient showing of compliance with the 41 MW precondition. However, the Commission also expressed concern about KG&E's current rates. Therefore, it made the rate increase interim and subject to refund to allow the KCC staff and CURB to investigate more fully the issues surrounding KG&E's need for an additional rate increase.

One of the areas CURB investigated more fully was the manner in which KG&E met the 41 MW precondition. As stated above, the KCC determined that KG&E could meet this precondition through "peak growth or reduced overall generating capability."

It was immediately apparent that KG&E had not met the precondition in terms of reduced overall generating capability, which declined by only four MW between 1986 and 1988. Therefore, KG&E chose to emphasize the decrease in *system* capability as opposed to *generating* capability.[3] KG&E's *system* capability, as opposed to *generating* capability, decreased by 62 MW between 1986 and 1988. The majority of that decrease is attributable

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[3] System capability is generating capability plus or minus the net effect of capacity purchases and sales.

to the 41.2 MW, 15 year, sale of capacity to OMPA. As already stated, the capacity that was sold was some of KG&E's least expensive.

The sale became an issue in this case because, as stated above, KG&E chose to rely upon it in establishing the Company's "need" to move the final 41 MW of Wolf Creek into its Kansas retail rate base. CURB considered it inequitable for KG&E to sell some of its cheapest power out-of-state and then to use that sale as a justification for placing more of its most expensive generating capacity in Kansas retail rates.

CURB's adjustment to deal with this inequity was conceptually simple. Its premise was that Kansas retail ratepayers should not have to pay the difference between the revenues received from the sale and the costs associated with an identical share of Wolf Creek. That difference amounted to $13.5 million.

The KCC adopted CURB's adjustment, finding as follows:

> It must be noted that this adjustment, which may be considered novel in terms of this Commission, is being made because of the novel circumstances in this docket. This is not a simple sale of excess power by one utility to another. It is a case of one utility selling its cheapest and lowest cost capacity to another, while including its highest cost capacity in rates paid by its jurisdictional, captive ratepayers. Even more importantly, this sale was used as justification for including that high-cost capacity in rates and the resulting interim rate increase at issue in this docket. KG&E met part of the condition precedent established by this Commission for including the revenue impact of the Ripley retirement with KG&E's January 1, 1989, rate increase by increasing its capacity sales by 43 MW between 1986 and 1988.

Included in those 43 MW is the 41.2 MW of capacity committed for 15 years to OMPA. This capacity sale supported KG&E's position that its overall system generating capability had been reduced sufficiently to justify including the revenue impact of the Ripley retirement with KG&E's January 1, 1989, rate increase. (Transcript of December 21, 1988, hearing in this docket, p. 19) (KG&E App. 57a-58a).

KG&E's entire argument to this Court regarding the OMPA-related adjustment is misdirected. The KCC's action had no effect on the contract between KG&E and OMPA. The contract rate was not reviewed and was not even an issue in this case. The sale itself would not have been an issue had not KG&E chosen to make it one by relying upon the sale to justify placing an identical amount of Wolf Creek into its Kansas retail rate base. Thus, in this case, the KCC was not reviewing the propriety of the rate or the terms of the contract. It was not even reviewing the propriety of KG&E entering into the contract. What the KCC did do was protect captive Kansas customers from the detrimental impacts of placing additional Wolf Creek capacity into retail rates. The OMPA sale simply provided a basis for calculating those detrimental impacts, which was entirely appropriate considering KG&E's reliance on the sale as a justification for increasing its Kansas retail rates. As the Kansas Court of Appeals found:

> FERC regulates the sale of wholesale power. The KCC's actions in imputing revenue at Wolf Creek rates does not affect the FERC-filed rates. Since the KCC is not regulating the same activity, it seems there can be no conflict, and the Supremacy Clause does not prohibit the KCC's actions. (KG&E App. 19a).

II. THE KANSAS CORPORATION COMMISSION ACTED WITHIN ITS JURISDICTIONAL AUTHORITY IN PROTECTING CAPTIVE RETAIL RATEPAYERS FROM SOME OF THE DETRIMENTAL IMPACTS ASSOCIATED WITH PETITIONER'S ATTEMPTS TO INCLUDE ADDITIONAL GENERATING CAPACITY IN ITS RETAIL RATES

It is undisputed that the states have a substantial, legitimate interest in regulating intrastate rates. *New Orleans Pub. Serv. v. New Orleans*, 491 U.S. ___, ___, 105 L.Ed.2d 298, 315 (1989). Also see *Central Hudson Gas & Electric Corp. v. Public Service Comm'n of New York*, 447 U.S. 557, 569 (1980). In fact, "the regulation of utilities is one of the most important functions traditionally associated with the police power of the States." *Arkansas Elec. Coop. v. Ark. Public Serv. Comm'n*, 461 U.S. 375, 377 (1983), citing *Munn v. Illinois*, 94 U.S. 113 (1877). In the Federal Power Act (FPA), Congress mandated federal regulation of electricity transmitted or sold at wholesale in interstate commerce. Such federal regulation, however, does not extend to areas traditionally regulated by the states. 16 U.S.C. § 824(a) and (b). In reviewing of the legislative history of the Act, this Court has noted that the bill was enacted to fill a regulatory gap -- to supplement state regulation, not to impair or diminish any existing state regulatory powers. See *Connecticut L. & P. Co. v. Federal Power Com'n*, 324 U.S. 515, 525-527 (1945).

In its petition, KG&E alleges that the KCC's action violates the filed rate doctrine and analogizes this case to *Nantahala Power and Light Co.* and to *Mississippi Power*. The filed rate doctrine was established by this Court in *Montana-Dakota Utilities Co. v. Northwestern*

Public Service Company, 341 U.S. 246 (1951). Essentially, the doctrine is that the rate filed with FERC is the only legitimate rate. The purchaser's right to a reasonable wholesale rate is the right to the FERC-approved rate. Except for a narrow review of FERC orders,- the court can assure no right to a different rate on the ground that, in its opinion, another rate is more reasonable. In *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981), the doctrine was transformed into a rule of preemption under which state courts must recognize the inviolability of wholesale rates on file with or approved by FERC. The parameters of the doctrine were examined further in *Nantahala Power and Light Co.* and *Mississippi Power*.

In *Nantahala Power and Light Co.*, FERC had determined that a certain allocation of purchased power between two affiliated companies was just and reasonable. The state commission, however, found the allocation to be unjust and unreasonable and adopted another allocation to replace it. This Court overturned the state commission order, finding that FERC had jurisdiction to allocate power between affiliates and that a FERC-approved allocation must be followed by the state regulatory body. Because the state commission had adopted a different allocation, the utility had experienced "trapped costs," which are prohibited. That is, the utility was incurring FERC-mandated purchased power costs at a FERC-approved rate that the Company could not recover through retail rates by virtue of a state commission order that contradicted FERC's allocation. *Id.*, 476 U.S. at 970-973. Thus, in that case, the filed rate doctrine was used to uphold FERC's authority to allocate power among affiliated utilities and to prevent such allocations from being altered by the states.

In *Mississippi Power*, the Court dealt with the same issue -- a power allocation (in the form of a pooling agree-

ment) between affiliated companies. The Court again upheld FERC's preemptive jurisdiction to allocate power among affiliates, relying on its decision in *Nantahala Power and Light Co.* As the Court stated, "The facts of this case and *Nantahala* are not distinguishable in any way that has relevance to the operation of the principles stated above." *Mississippi Power*, 487 U.S. at 372.

The Kansas Court of Appeals accurately presented the relevant facts and the holdings of *Nantahala Power and Light Co.* and *Mississippi Power* in its opinion (KG&E App. 17a-18a). It declined to extend those holdings to the facts of this case, stating:

> In the instant case, KG&E is not the buyer of the wholesale power, but the seller. In *Nantahala* and *Mississippi Power*, the affected utility was the buyer of the wholesale power. The wholesale rates paid by OMPA were not affected and OMPA was not prohibited from recovering the FERC-approved rates. The cases simply do not address the effect of state regulation on the seller of the wholesale power that recovers the FERC-filed rate. (KG&E App. 18a).

The Kansas Court of Appeals was correct in holding that *Nantahala Power and Light Co.* and *Mississippi Power* are not directly applicable to this case because of its unique evidentiary and procedural facts. The basis of those holdings -- trapped costs resulting from a FERC-approved rate[4] -- is not present here.[5] Those cases deal

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[4] *Nantahala Power and Light Co.*, 476 U.S. at 970.

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[5] Although KG&E attempts to argue that it has experienced trapped costs (see p. 19, note 17 of KG&E's petition) nothing could be further from the truth. KG&E's retail revenue requirement was reduced below the level considered appropriate by KG&E. The adjustment

with the pass-through of FERC-mandated costs -- not with FERC-approved sales that create revenue. Those cases would be directly applicable here if KG&E had bought power from OMPA, and the KCC had found the FERC-approved rate to be unreasonable, and on that basis had refused to allow KG&E to recover that cost through retail rates. However, in trying to extend those holdings to this situation, KG&E is faced with making an argument that is facially invalid -- i.e. that because FERC has approved the amount of additional revenue KG&E is receiving from the OMPA sale, the KCC is preempted from reviewing KG&E's attempts to place additional capacity in its retail rate base and to raise its retail rates.

This is not to say, of course, that FERC jurisdiction does not extend to sellers of interstate wholesale electricity. As the Kansas Court of Appeals correctly noted, however, the KCC is not regulating the same activity that FERC is regulating. (KG&E App. 19a). FERC simply determined that the rate at which the capacity was sold to OMPA was just and reasonable, and that is all that FERC determined. The KCC did not even review the rate, let alone question it. It simply was not an issue in the case. Neither did the KCC question the propriety of the sale. Instead, the KCC reviewed all elements of KG&E's retail cost of service, including the cost associated with adding additional Wolf Creek capacity to retail rate base. KG&E's partial justification for this increased cost was that the Company had less capacity available to

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at issue, however, was based upon the costs of the Wolf Creek capacity being brought into retail rate base -- not the cost of the capacity sold to OMPA. The revenue received from the OMPA sale was used as an offset to the Wolf Creek costs. KG&E, however, was benefitted -- not harmed -- by that offset, because it reduced the amount of the adjustment.

meet its retail demand because of the OMPA sale. The revenue from the OMPA sale was more than offset by the additional cost of moving additional, replacement Wolf Creek capacity into retail rate base. The KCC-adopted adjustment allowed KG&E to move the Wolf Creek capacity into retail rate base, but protected retail ratepayers from those added costs. In *Nantahala Power and Light Co.*, this Court recognized the appropriateness of this type of state regulatory scrutiny. *Id.*, 476 U.S. at 967-968.

Not mentioned by KG&E in its petition is a decision by the Court that is helpful in this case because it clarifies the limits of the holdings in *Nantahala Power and Light Co.* and *Mississippi Power*. In *New Orleans Pub. Serv.* this Court considered whether federal courts should abstain from deciding a preemption challenge to a Louisiana ratemaking order. In determining whether abstention was appropriate, the Court was required to decide whether a valid claim of preemption existed. Abstention by a federal court is not an issue in this case. The Court's opinion is instructive, however, because it reviews types of state action that would be preempted. In concluding that there was no colorable claim of preemption in that case, the Court stated:

> The Council has not sought directly to regulate interstate wholesale rates; nor has it questioned the validity of the FERC-prescribed allocation of power within the Grand Gulf system, or the FERC-prescribed wholesale rates; nor has it reexamined the prudence of NOPSI's agreement to participate in Grand Gulf 1 in the first place. Rather, Council maintains that it has examined the prudence of NOPSI's failure, after the risks of nuclear power became apparent, to diversify its supply portfolio, and that finding that failure

> negligent, it has taken the normal ratemaking step of making NOPSI's shareholders rather than the ratepayers bear the consequences. Nothing in this is directly or even indirectly foreclosed by the federal statute, the regulations implementing it, or the case law applying it. *Id.*, 491 U.S. at ___, 105 L.Ed.2d at 316.

The KCC's action in this case does not fall within any of the prohibited state activities listed by the Court in *New Orleans Pub. Serv.* Also apropos to this case is the Court's rejection in that case of the utility's argument "that under the particular facts of the present case its FERC-allocated wholesale costs are not a proper subject for such (state) proceedings." KG&E has made the identical argument in this case with regard to the revenues received from the OMPA sale. In rejecting the utility's argument in *New Orleans Pub. Serv.*, the Court said "this argument of NOPSI ultimately reduces once again to insistence upon too narrow an analytical focus." *Id.*, 491 U.S. at ___, 105 L.Ed.2d at 315-316.

CONCLUSION

For the above and foregoing reasons, the Court should deny KG&E's petition for a writ of certiorari.

Respectfully submitted,

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February 27, 1991

(4)

No. 90-984

In The

Supreme Court of the United States

October Term, 1990

Kansas Gas and Electric Company,
Petitioner,

v.

State Corporation Commission
of the State of Kansas, *et al.*
Respondents.

Petition for Writ of Certiorari to the Court of Appeals of the State of Kansas

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BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether a state regulatory commission violates the Supremacy Clause, in particular, the filed rate doctrine, when in the exercise of traditional ratemaking authority, the commission imputes revenue to the sale of low-cost power when the jurisdictional utility uses the sale to justify including other, high-cost capacity in rate base.

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No. 90-984

IN THE
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KANSAS GAS AND ELECTRIC COMPANY,
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v.

STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS, *et al.*
Respondents.

Petition for Writ of Certiorari to the Court of Appeals of the State of Kansas

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondents, State Corporation Commission of the State of Kansas (KCC), respectfully pray that the petition for writ of certiorari filed by petitioner, Kansas Gas and Electric Company (KG&E), be denied.

STATEMENT OF THE CASE

A. Introduction

The history of this case is not limited to a single administrative decision and its judicial review. The rulings in contention stem from more than five years of admin-

istrative proceedings over the serious issue of who should pay for the higher costs of a nuclear power plant. The utility ratepayers and the utility shareholders have battled over what portion of those costs each should fairly bear. In the lawful exercise of its regulatory authority, the KCC has carefully and consistently maintained an equitable sharing of these costs and benefits.

B. Facts

This case begins with KG&E's construction of the Wolf Creek Nuclear Generating Station (Wolf Creek) at a cost of more than six times the original estimate[1] and with a capacity that greatly exceeded demand. In a series of orders issued over the last five years, the KCC has attempted to soften the economic impact to KG&E's ratepayers from a full rate base treatment of Wolf Creek while simultaneously balancing the utility's need for revenue and right to an opportunity to earn a return on investment.[2] The particular KCC order at issue here, part of that sequence, was issued on February 13, 1990,[3] and addressed, *inter alia*, revenue requirement issues arising out of a KCC staff audit of KG&E's cost of service.

In November 1984, KG&E applied for a rate increase to offset an estimated test year deficiency of $373,427,835, principally caused by Wolf Creek operations. The KCC,

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[1] In 1973, the cost to construct Wolf Creek was estimated at $525 million. Completed in 1985, the ultimate cost of construction amounted to over $3 billion.

[2] This balancing process was expressly mandated in *Kansas Gas & Electric Co. v. State Corporation Commission of the State of Kansas*, 239 Kan. 483, 490, 720 P.2d 1063, 1071-1072 (1986).

[3] Petitioner's App. C at 25a.

in orders issued in the fall of 1985,[4] found a deficiency of $169.9 million and set out a schedule for phasing in rate increases to meet this deficiency.[5] The KCC also determined that Wolf Creek had 269 megawatts (MW) of excess capacity[6] which created an economic risk that had to be shared between KG&E's ratepayers and shareholders. By utilizing a risk-sharing approach and by phasing in the necessary rate increases, the KCC attempted to alleviate the adverse impact (rate shock) to ratepayers and the state economy.

These original Wolf Creek orders were modified by the KCC's Rate Stabilization Order issued March 11, 1987.[7] The importance of the Rate Stabilization Order to

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[4] The KCC orders granting KG&E's rate increases were affirmed on appeal in *Kansas Gas & Electric Co. v. State Corporation Commission of the State of Kansas*, 239 Kan. 483, 720 P.2d 1063 (1986). This Court noted probable jurisdiction of this rate treatment on February 23, 1987, in *Kansas Gas & Electric Co. v. State Corporation Commission of Kansas*, 479 U.S. 1082 (1987), but later dismissed the appeal as moot in *Kansas Gas & Electric Co. v. State Corporation Commission of Kansas*, 481 U.S. 1044 (1987).

[5] The phase-in was set out as follows:

Year	*Amount (Millions)*
1985	$135.0
1986	20.0
1987	14.6
1988	15.6 (5 years to cover deferred phase-in revenues.)

[6] Kan. Stat. Ann. (K.S.A.) 66-128c (1985) defines "excess capacity" as "any capacity in excess of the amount used and required to be used to provide adequate and reliable service to the public." Respondents' App. at 22.

[7] Petitioner's App. F at 120a. The Rate Stabilization Order allowed KG&E to delay the third scheduled increase of $14.6 million until January 1, 1989, previously approved on an interim basis in the Wolf Creek rate order and made that increase permanent. The KCC further allowed KG&E to delay the fourth increase until January 1, 1992.

this appeal is that the scheduled increases were changed from an interim basis to a permanent one. The KCC, however, left open the possibility for later challenges to the third and fourth scheduled increases.[8]

In an order handed down March 19, 1987, the KCC approved KG&E's application to retire its Ripley Steam Electric Station (Ripley) and to include an additional amount of Wolf Creek's excess capacity in KG&E's rate base as an offset to the Ripley retirement. The effect of this action was to include 46 MW of Wolf Creek (representing one-half of Ripley's 92 MW capacity) in KG&E's rate base and to establish a condition to the inclusion of the other 46 MW of Wolf Creek. The KCC added the revenue impact from the Ripley retirement[9] to the third rate increase scheduled to take effect on January 1, 1989, upon one condition. KG&E was required to demonstrate its need for more Wolf Creek capacity, "whether from peak growth or reduced overall generating capacity, . . . [had] grown by 41 MW from 1986 to 1988 so as to justify adding the incremental revenue impact to the January 1, 1989, increase."[10] The full revenue impact of the Ripley retirement brought the third increase to $29 million rather than the original $14.6 million.

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[8] The KCC observed that it had the "right to re-examine all elements of KG&E's revenue requirements should it appear that its earnings or rates are unreasonably high." Petitioner's App. F at 150a. The KCC eventually eliminated the fourth increase in its Rate Modification Order issued July 15, 1988.

[9] The revenue impact from the Ripley retirement, $14.4 million, was determined according to the parameters set forth in the KCC's March 11, 1987 order. Petitioner's App. F at 134a, 135a.

[10] Petitioner's App. F at 135a. These findings were adopted and reaffirmed in the KCC order issued March 19, 1987, which approved the Ripley retirement.

The KCC scheduled a hearing for December 21, 1988, to determine whether KG&E had met the condition of a 41 MW growth in the need for Wolf Creek capacity. The Citizens' Utility Ratepayers Board (CURB), in advance of the hearing, filed a motion challenging the need for the rate increase attributable to the Ripley retirement and requesting the KCC to change this increase to an interim status, subject to refund. In its order issued December 30, 1988,[11] the KCC found that KG&E had met the 41 MW condition and allowed the inclusion of the additional Wolf Creek capacity in KG&E's rate base. Concerned with whether the resulting rate level would be an appropriate risk-sharing balance, the KCC made the corresponding $14.4 million increase interim and subject to refund[12] pending a staff investigation and audit of KG&E's rates.[13]

At the technical hearing held eleven months later in November 1989, KCC staff recommended that KG&E be

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[11] Petitoner's App. E at 102a.

[12] KG&E appealed this order to the Kansas Court of Appeals which vacated, in an unpublished opinion, the aspect of the KCC's decision changing the status of the rates. *Kansas Gas & Electric Co. v. State Corporation Commission of the State of Kansas*, No. 63,400, (Kan.Ct. App. filed June 4, 1990).

[13] The KCC set out its rationale as follows: "During the past four years the Commission has attempted to achieve equitable solutions to the problems associated with bringing Wolf Creek on-line. This has necessitated a sharing of the burdens and benefits associated with Wolf Creek between KG&E and its ratepayers. The Commission is concerned with the risk-sharing aspect of KG&E's rates. In order to determine if the appropriate level of risk-sharing is reflected in rates, especially in light of actions taken by the Company since approval of the Rate Stabilization Plan, the Commission believes an audit of KG&E's rates is necessary." Petitioner's App. E at 105a-106a.

allowed to retain the Ripley portion of the rate increase and that the increase be made permanent. KG&E urged the KCC to adopt staff's recommendation. The CURB presented testimony in favor of reducing rates. The CURB argued that the KCC should re-examine the accounting treatment of KG&E's off-system sale of 41.2 MW to the Oklahoma Municipal Power Authority (OMPA). KG&E had allocated its cheapest, gas-fired capacity to the sale. The effect was to artificially imbalance the KCC's time-tested, risk-sharing strategy. The KCC found that KG&E had used the OMPA sale to meet the 41 MW condition for including Wolf Creek capacity in rate base and to obtain the accompanying $14.4 million increase. Petitioner's App. C at 58a. Accordingly, the KCC issued the February 13, 1990, order in which it decreased KG&E's revenue requirement by $13.5 million.

KG&E appealed the KCC's orders of February 13, 1990, and March 21, 1990,[14] to the Kansas Court of Appeals. One of KG&E's issues on appeal was whether the imputation of revenue to a wholesale power contract violated the Supremacy Clause of the United States Constitution.[15] The Kansas Court of Appeals held that the KCC's imputation of revenue did not affect the wholesale rates filed with the Federal Energy Regulatory Commission (FERC). The court further found the FERC's regulation of the OMPA sale and the KCC's regulation of retail rates were not the same activity and caused no conflict that would give rise to pre-emption.[16] KG&E's

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[14] The KCC's order of March 21, 1990, modified the February 13, 1990, order and denied petitions for reconsideration. Petitioner's App. D at 97a.

[15] U.S. Constitution, Article VI, Clause 2.

[16] *Kansas Gas & Electric Co. v. State Corporation Commission of the State of Kansas*, No. 64,976, (Kan. Ct. App. filed June 29, 1990). Petitioner's App. A at 16a.

petition for review of this decision was denied by the Kansas Supreme Court. The KCC submits that the issue now before this Court is not worthy of the Court's attention.

SUMMARY OF THE ARGUMENT

The KCC respectfully requests that the Court deny KG&E's petition for writ of certiorari. KG&E argues at some length that the issue it places before this Court is of great national importance due to "ongoing tension" between the spheres of federal and state authority. However, the only tension that exists in this case is a continuing and shifting one between KG&E's shareholders and its ratepayers. The KCC's decision imputing Wolf Creek costs to a KG&E sale of wholesale power to the OMPA was nothing more than a matching of costs with benefits, a state retail ratemaking concept clearly preserved under the Federal Power Act.

ARGUMENT FOR DENYING THE PETITION

I. THE KCC LAWFULLY EXERCISED TRADITIONAL STATE RATEMAKING AUTHORITY.

This case presents a garden variety example of traditional state ratemaking being performed to serve the public interest. The KCC has acted consistently with the principles governing the separation of federal and state regulation of power. In its petition, KG&E has distorted the purpose and effect of the KCC's actions in an apparent effort to create a federal constitutional argument for extending the pre-emption doctrine to exclude state ratemaking authority to match costs with benefits when a jurisdictional utility sells power in a wholesale transaction. This brief will reveal the inaccuracies and fallacies with KG&E's argument and logic.

The Federal Power Act (FPA) gave the Federal Power Commission, now the FERC, the authority to regulate wholesale-level sales, while preserving the states' traditional authority over retail rate regulation. 16 U.S.C.A. § 824 (b)(1)(1985). This division between federal and state authority is referred to as the jurisdictional "bright line." *Panhandle Eastern Pipeline Co. v. Public Service Commission*, 332 U.S. 507, 517 (1947).[17] A related concept is the "filed rate doctrine" which makes the FERC's determination of a reasonable rate, in a wholesale FERC-regulated transaction, final and subject only to direct judicial review. *Montana-Dakota Utilities Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246 (1951). As will be shown later, KG&E improperly applies the filed rate doctrine to this case.

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[17] Although *Panhandle Eastern* was decided under the Natural Gas Act rather than the FPA, this Court has recognized the substantial similarity between the two acts and therefore cites cases arising under both acts interchangeably. *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981).

Congress gave the FERC specific regulatory authority over "rates and charges made, demanded, or received by any utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission." 16 U.S.C.A. § 824d(a) (1985). The FERC determines whether such rates and charges are just and reasonable and not unduly preferential, discriminatory, or disadvantageous to any party. 16 U.S.C.A. §§ 824d (1985), 824e (P.P. 1990).

In contrast to the FERC's authority, the KCC is conferred the "full power, authority and jurisdiction to supervise and control the electric public utilities . . . doing business in Kansas. . . ." Kan. Stat. Ann. (K.S.A.) 66-101 (1985). Respondents' App. at 21. The KCC's jurisdiction "shall be liberally construed" and the KCC is granted "all incidental powers necessary" to effectuate the regulation of electric public utilities. K.S.A. 66-101g (1985). Respondents' App. at 22. Kansas law further obligates the KCC to investigate all rates of electric utilities. K.S.A. 1990 Supp. 66-101d. Respondents' App. at 21. The KCC's authority includes reviewing and evaluating the "efficiency or prudence" of any actions and practices of any public utility "for the purpose of establishing fair and reasonable rates." K.S.A. 66-128a (1985). Respondents' App. at 22.

The KCC submits that its lawful exercise of statutory authority here neither is incompatible with nor erodes the FERC's exclusive jurisdiction over wholesale rates. KG&E argues the KCC's revenue adjustment imputing Wolf Creek costs to the OMPA sale somehow questions or undermines the FERC's sole power to approve wholesale power contracts. A closer look at the KCC's order reveals that the KCC never challenged any FERC determination and, in fact, limited its actions to accounting treatment only.

In March 1987, the KCC allowed KG&E to increase its third rate increase from $14.6 million to $29 million by expanding its rate base with an additional 46 MW of Wolf Creek capacity. This increase was conditioned upon KG&E showing a 41 MW peak demand growth or reduced overall generating capability. To meet this condition, KG&E chose to rely on the off-system sale of its cheaper, gas-fired capacity to the OMPA. As the KCC found in its February 13, 1990, order, the "[OMPA] sale was used as justification for including the high-cost [Wolf Creek] capacity in rates" paid by its jurisdictional, captive ratepayers. Petitioner's App. C at 58a. That finding is not in dispute.

The 46 MW of Wolf Creek capacity was not included in KG&E's rate base before the OMPA sale, because the KCC had found that capacity was "excess capacity" and not "used and required to be used." K.S.A. 66-128c (1985). Respondents' App. at 22. When it used the OMPA sale to justify including this capacity in rate base, KG&E was able to transform unneeded Wolf Creek capacity into used and useful capacity. Without the OMPA sale, this 46 MW of Wolf Creek capacity was unneeded and did not deserve rate base treatment; with the OMPA sale, this Wolf Creek capacity was useful and did deserve rate base treatment. It is important to note that the KCC did recognize the sale, never questioned the FERC determination, and included the additional Wolf Creek capacity.

KG&E's use of the OMPA sale, however, was not allowed without condition. The KCC insisted that KG&E be treated as earning revenues from the OMPA sale equal to the cost to retail ratepayers of the Wolf Creek inclusion. In placing this condition on KG&E, the KCC did no more than require the customary matching of costs and benefits associated with inclusion of capacity in rate base.

Part of the confusion in this case comes from KG&E's emphasis on inclusion of Wolf Creek **capacity** in rate base. Rate base involves not only **capacity**, but also the **costs of that capacity**. Under standard ratemaking practice, costs are included in rate base, and thus billed to the ratepayer, only if they produce a corresponding value for the ratepayer.[18] Regulators cannot permit a monopolistic utility to charge ratepayers for a cost without insisting on a corresponding benefit.

The KCC's decision has a simple and compelling logic. If the captive customers have to pay for the Wolf Creek capacity that was justified by the OMPA sale, then they are entitled to revenues associated with a Wolf Creek sale. If KG&E could not produce these revenues, the KCC must set retail rates as if KG&E had produced the revenues. Only when the revenues -- actual or imputed -- match the costs are ratepayers protected. Thus, the KCC's imputation of revenue simply equalized the ratemaking treatment to be afforded to the sale under traditional state retail ratemaking principles.

II. THE KCC'S ORDERS DO NOT VIOLATE THE FILED RATE DOCTRINE SET OUT IN *NANTAHALA* AND *MISSISSIPPI POWER AND LIGHT*.

From KG&E's standpoint, the KCC's order is preempted by the FPA and the filed rate doctrine. For support, KG&E proposes an unreasonably expansive interpretation and application of recent Supreme Court decisions. In contrast, the KCC simply argues that the filed rate doctrine is not implicated here and that its

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[18] K.S.A. 66-128c (1985) makes the standard practice the law in Kansas, i.e., capacity must be "used and required to be used" for inclusion in rate base. Respondents' App. at 22.

orders pose no threat of intruding upon or otherwise eroding the FERC's authority under the FPA.

The filed rate doctrine is a judicial creation that has undergone some refinement. In *Narragansett Elec. Co v. Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978), the doctrine was interpreted to preclude the state utility commission from inquiring into the reasonableness of the FERC-approved wholesale rate and from refusing to treat the rate as other than a reasonable operating expense in the company's retail cost of service. The Supreme Court has embraced this development holding that:

> "[A] state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price . . . Once FERC sets such a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. A state must rather give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority." *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 373, (1988) (quoting *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 965 (1986)).

The rationale for this rule is to ensure that sellers of wholesale power do not have their costs of paying the FERC-determined rates trapped and left unrecoverable by the state's refusal to account for these costs in setting retail rates. *Nantahala*, 476 U.S. at 970.

KG&E asserts that the imputation of Wolf Creek costs to the OMPA sale results in "trapped costs" signaling a violation of the filed rate doctrine. KG&E's alleged "trapped costs" are the weak link to its pre-emption arguments

because these purported costs are unlike anything found in this Court's prior decisions. In *Nantahala,* the utility lost its chance to recover the cost of purchasing power at FERC-set rates because the state commission, in setting retail rates, imputed to the utility a lower average cost of power. *Id.* at 970. In *Mississippi Power*, the utility's cost in purchasing a FERC-allocated portion of nuclear-generated power would have been trapped if the state commission, after conducting its prudence review, had concluded the cost should not be passed on to the ratepayers. In both cases, the state's action directly prevented the utility from recovering its FERC-determined costs through its retail rate charges. In contrast, KG&E has neither shown nor argued that its FERC-set costs from the OMPA sale were lost as a result of the KCC's imputation.

The KCC order does not preclude KG&E or the OMPA from recovering their respective costs of paying the FERC-approved OMPA rate. To illustrate, FERC set the rate for the sale of power from KG&E as seller to the OMPA as wholesaler-as-buyer. Any retail sales occurring as a result of this transaction would presumably take place in Oklahoma with the OMPA's ratepayers. It is the regulation of this sale, the sale from the OMPA to the ultimate Oklahoma consumer, which could come under consideration for violating the filed rate doctrine. In other words, Oklahoma could not exercise its jurisdiction over retail sales to prevent the OMPA from recovering the costs of paying the FERC-approved rate to KG&E.

KG&E badly misconstrues the concept of "trapped costs." In footnote 17 at page 19 of its petition, KG&E states that, "trapped costs occur when state regulators set retail rates that prohibit full recovery of the revenue requirement generated by FERC-approved wholesale ar-

rangements." KG&E wants to transform its entire revenue requirement into a FERC determination because some FERC-imposed costs had been calculated into the revenue requirement. Such reasoning would obliterate any role of state regulation of local sales of power and frustrate the intent behind the FPA. The KCC's actions were well within its jurisdiction. The KCC sought to mitigate the economic impact to ratepayers when more Wolf Creek capacity was added to KG&E's rate base. By imputing revenue, the KCC was able to reduce KG&E's revenue requirement and thereby its retail rates. The KCC was only exercising its proper authority in balancing burdens and benefits between shareholders and ratepayers.

Both *Nantahala* and *Mississippi Power* involved the trapping of **FERC-imposed** costs. KG&E contends the KCC prevented it "from recovering these Wolf Creek costs by pretending that FERC had allowed them to be charged to OMPA." Petition, p. 19 n. 17. The FERC's approval of the OMPA sale did not entail any corresponding determination or allocation of KG&E's cost of Wolf Creek power. KG&E sold to the OMPA its cheaper, gas-fired power, not its more expensive, nuclear-generated power from Wolf Creek. The FERC, therefore, had no reason to evaluate or approve KG&E's costs in Wolf Creek. Unlike *Nantahala* and *Mississippi Power*, the state's action here does not result in any trapping of **FERC-determined** costs.

A final significant distinction is that in both *Nantahala* and *Mississippi Power*, the "trapping" took place because the FERC approved the reasonableness and price of a wholesale transaction, but the state regulators second-guessed the FERC decision. The buying utility, an affiliated interest of the seller, had no legal mind of its own, yet the state commission treated the purchasing

utility as having the ability to shop for alternative power. Here, no agency obligated KG&E to sell to the OMPA. KG&E's decision to sell was purely **voluntary.** The "trapped cost" argument does not apply, for the simple reason that there is no "trap."

In forcing the application of the filed rate doctrine, KG&E blurs the distinctions between this case and the cases of *Nantahala* and *Mississippi Power* in which this Court carefully delineated trapped cost analysis. KG&E's argument that it lost FERC-determined costs has a fictitious premise. If KG&E had sold power generated at Wolf Creek in its wholesale sale to the OMPA, then the FERC presumably would have determined a reasonable rate of recovery on KG&E's cost of generating that power. Because the KCC imputed the costs of Wolf Creek power to the OMPA sale, KG&E believes it was improperly denied both a **FERC determination** of those generating costs and **recovery** of them. In other words, KG&E's argument of trapped costs is based on imputing actions to the FERC. KG&E did not sell Wolf Creek power to the OMPA and the FERC had no reason to consider KG&E's costs in generating such power. Simply stated, KG&E has suffered no trapped costs due to existing, inconsistent orders from the FERC and the KCC.

The Kansas Court of Appeals relied upon another distinction. The Supreme Court in *Nantahala* and *Mississippi Power* applied the filed rate doctrine to protect a buyer of wholesale power. Indeed, the Court said: "The filed rate doctrine ensures that sellers of wholesale power, governed by FERC, can recover the costs incurred by their payment of just and reasonable FERC-set rates." *Nantahala*, 476 U.S. at 970. In the instant case, KG&E is not a buyer of wholesale power at FERC-set rates, but the seller. The Kansas Court of Appeals read both *Nantahala* and *Mississippi Power* as "not address[ing] the

effect of state regulation on the seller of the wholesale power that recovers the FERC-filed rate."[19] KG&E distorts this plain reading of Supreme Court precedent in arguing that the Kansas court rejected the FERC's exclusive jurisdiction over sellers in a wholesale power transaction. The KCC proposes the buyer-seller distinction is viable in this case primarily because KG&E, as the seller, is unable to prove that any FERC-determined cost was trapped as a result of the KCC's action.

At page 25 of its petition, KG&E wrongly asserts that the Kansas Court of Appeals engaged in case-by-case analysis to avoid finding pre-emption and thus ignored the intent of Congress to establish a mechanical bright line test for distinguishing between federal and state jurisidiction.[20] On the contrary, the Kansas court applied the bright line test to determine that KG&E's OMPA sale was a wholesale transaction subject to the FERC's jurisdiction. Once the court made this determination, its responsibility then shifted to determining whether the KCC properly treated the OMPA sale under the filed rate doctrine. The Kansas court fully recognized that the filed rate doctrine prohibits a state from impermissibly interfering with the scheme of federal regulation. However, a determination of interference under the filed rate doctrine necessarily entails some factual analysis which does not conflict with Congressional intent. KG&E ignores the fact that the filed rate doctrine, though related to the bright line jurisdictional test, is a distinct legal concept. The Kansas Court of Appeals properly applied the filed rate doctrine and found the KCC's actions were not preempted. The KCC properly exercised its authority in

[19] Petitioner's App. A at 18a.

[20] This Court enunciated Congress' intent in *Illinois Natural Gas Co. v. Central Illinois Public Service Co.*, 314 U.S. 498 (1942).

balancing burdens and benefits between shareholders and ratepayers, a traditional and time-tested state authority that this Court has never held pre-empted when the transaction is tangentially touched by the FERC.

III. THE QUESTION PRESENTED CARRIES NO NATIONAL IMPORTANCE

This case presents a classic example of a state utility commission exercising its customary ratemaking power to achieve an equitable result for the regulated utility and the ratepaying public. Of its own volition, KG&E made an off-system sale of low-cost, gas-fired power and then used that sale to justify including additional high-cost, nuclear-generated power in its rate base. The KCC was faced with the problem of determining the propriety and value of including the added Wolf Creek capacity into KG&E's rate base. The additional Wolf Creek capacity **was included**, but the OMPA sale of low-cost, gas-fired power did not justify inclusion of the nuclear capacity at full cost. The KCC imputed revenue to obtain the traditional matching of costs and benefits, a perfectly appropriate and justified state ratemaking technique. The KCC did not refuse to accept any FERC-filed rate. KG&E suffered no trapped costs. Accusations of parochialism and protectionism cannot elevate a simple ratemaking decision to a federal constitutional question. The KCC acted fully within the powers preserved to it by the FPA. This case has no national importance.

CONCLUSION

KG&E's petition for writ of certiorari does not raise a substantial federal question. At issue in this appeal are administrative orders pertaining to the regulation of retail rates, a traditional state function. The KCC's orders do not impinge upon federal authority nor do they present an issue of national importance. KG&E's petition should be denied and the state court's decision affirmed in all respects.

Respectfully submitted,

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APPENDIX

66-101. Electric public utilities; power, authority and jurisdiction of state corporation commission. The commission is given full power, authority and jurisdiction to supervise and control the electric public utilities, as defined in K.S.A. 66-101a, doing business in Kansas, and is empowered to do all things necessary and convenient for the exercise of such power, authority and jurisdiction.

History: R.S. 1923, 66-101; L. 1969, ch. 302 § 2; L. 1981, ch. 255, § 1; L. 1985, ch. 224, § 1; L. 1985, ch. 225, § 7; July 1.

66-101d. Same; investigation of rates, tolls, charges and services; orders of commission; hearing. It shall be the duty of the commission, either upon complaint or upon its own initiative, to investigate all rates, joint rates, tolls, charges and exactions, classifications or schedules of rates or joint rates and rules and regulations of electric public utilities. If after hearing and investigation the commission finds that such rates, joint rates, tolls, charges or exactions, classifications or schedules of rates or joint rates or rules and regulations are unjust, unreasonable, unjustly discriminatory or unduly preferential, the commission shall have the power to fix and order substituted therefor such rates, tolls, charges, exactions, classifications or schedules of rates or joint rates and such rules and regulations as are just and reasonable.

If upon any investigation it is found that any regulation, measurement, practice, act or service complained of is unjust, unreasonable, unreasonably inefficient or insufficient, unduly preferential, unjustly discriminatory, or otherwise in violation of this act or of the orders of the commission, or if it is found that any service is inadequate or that any reasonable service cannot be obtained, the commission shall have the power to substitute therefor such other regulations, measurements, practices, service or acts, and to make such order respecting any such changes in such regulations, measurements, practices, service or acts as are just and reasonable. When, in the judgment of the commission, public necessity and convenience require, the commission shall have the power to establish just and reasonable concentration or other special rates, charges or privileges, but all such rates, charges and privileges shall be open to all users of a like kind of service under similar circumstances and conditions.

Hearings shall be conducted in accordance with the provisions of the Kansas administrative procedure act.

History: L. 1911, ch. 238, § 13; R.S. 1923, 66-110; L. 1985, ch. 225, § 25; L. 1988, ch. 356, § 220; July 1, 1989.

66-101g. Same; liberal construction; incidental powers granted. As applied to regulation of electric public utilities, the provisions of this act and all grants of power, authority and jurisdiction herein made to the commission, shall be liberally construed, and all incidental powers necessary to carry into effect the provisions of this act are expressly granted to and conferred upon the commission.

History: L. 1911, ch. 238, § 41; R.S. 1923, 66-141; L. 1985, ch. 225, § 43; July 1.

66-128a. Fixing rates, joint rates, tolls and averages; authority of commission not limited by 66-128b through 66-128i. Nothing in K.S.A. 66-128b to 66-128i, inclusive, shall be construed to limit the authority of the state corporation commission to review and evaluate the efficiency or prudence of any actions, including acquisition of excess capacity, or operating practices of any public utility or common carrier for the purpose of establishing fair and reasonable rates, joint rates, tolls and charges.

History: L. 1984, ch. 247, § 2; April 19.

66-128c. Valuation of property for rate making; evaluation of efficiency or prudence of utility; exclusion of all or a portion of costs of excess capacity, when; "excess capacity" defined; exclusion or reduction of return on costs from excess capacity. The state corporation commission, in determining the reasonable value of property under K.S.A. 66-128, and amendments thereto, shall have the power to evaluate the efficiency or prudence of acquisition, construction or operating practices of that utility. In the event the state corporation commission determines that a portion of the costs of acquisiton, construction or operation were incurred due in whole or in part to a lack of efficiency or prudence, or were incurred in the acquisition or construction of excess capacity, it shall have the power and authority to exclude all or a portion of those costs from the revenue requested by the utility.

For the purpose of this act, "excess capacity" means any capacity in excess of the amount used and required to be used to provide adequate and reliable service to the public within the state of Kansas as determined by the commission. The commission may in its discretion prohibit or reduce the return on costs which were incurred in constructing, maintaining or operating excess capacity.

History: L. 1984, ch. 247, § 4; April 19.

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No. 90-984

In the Supreme Court of the United States

OCTOBER TERM, 1990

KANSAS GAS AND ELECTRIC COMPANY, PETITIONER

v.

KANSAS STATE CORPORATION COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE STATE OF KANSAS

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

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QUESTION PRESENTED

Whether the Kansas Corporation Commission violated the Supremacy Clause when, for purposes of setting rates for petitioner's retail customers, it imputed revenue to petitioner in connection with an off-system, interstate sale of power subject to FERC's jurisdiction under Title II of the Federal Power Act.

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BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

This brief is submitted in response to the Court's order inviting the Solicitor General to file a brief expressing the views of the United States.

STATEMENT

Petitioner seeks further review of an order, issued by respondent State Corporation Commission of Kansas (KCC), concerning the rates petitioner may charge its retail customers for electric power. Petitioner asserts that KCC's treatment of an off-system sale of power to an Oklahoma utility infringed upon FERC's exclusive jurisdiction, under Title II of the Federal Power Act, 16 U.S.C. 824 *et seq.*, over interstate wholesale sales of power.

1. Petitioner owns a 47% interest in the Wolf Creek Nuclear Generating Station (Wolf Creek), a nuclear power plant capable of generating approximately 1,150 megawatts (MW) of electricity. Like many other nuclear plants, Wolf Creek proved far more expensive to build than was originally anticipated. In 1973, the cost of construction was estimated at $525 million. By the time the plant was completed, however, its cost had climbed to more than $3 billion. To make matters worse, the demand for power when the plant came on line fell well below earlier projections. Pet. App. 26a; Pet. 5; KCC Br. in Opp. 2 n.1.

a. In 1984, petitioner filed an application for a rate increase to recover the costs of Wolf Creek. The application sought an increase sufficient to make up an anticipated $373 million annual shortfall in the utility's revenues. In 1985, KCC issued orders providing for a series of rate increases designed to produce the equivalent of $169.6 million per year. Much of the difference between petitioner's request and the amounts awarded by KCC was attributable to KCC's finding that a substantial proportion of Wolf Creek's capacity was excess capacity, the full cost of which could not be passed on to petitioner's retail customers. Pet. App. 26a, 144a; *In re Wolf Creek Nuclear Generating Facility*, 70 P.U.R. 4th 475, 515-516 (Kans. Corp. Comm'n 1985).

The 1985 orders did allow petitioner to include 46 MW of the capacity in Wolf Creek in its rate base to compensate for the retirement of petitioner's 92 MW Ripley Station. Those orders also provided that an additional 46 MW of Wolf Creek capacity could be added to the rate base if petitioner demonstrated that it was prudent to retire the Ripley plant. *Wolf Creek*, 70 P.U.R. 4th at 514. See Pet. 5 n.6.

Petitioner sought judicial review of the 1985 ratemaking orders. The Kansas Supreme Court affirmed the orders. *Kansas Gas & Electric Co.* v. *State Corp. Comm'n*, 239 Kan. 483, 720 P.2d 1063 (1986). Petitioner appealed to this Court, arguing that the rates mandated by the 1985 orders were confiscatory. This Court noted probable jurisdiction. 479 U.S. 1082 (1987).

b. In March 1987, KCC approved petitioner's application to retire the Ripley plant. The same month, KCC entered an order, referred to as the Rate Stabilization Order, that modified the 1985 orders in a number of respects. Among other things, the Rate Stabilization Order provided, subject to one condition, for the inclusion of the additional 46 MW of Wolf Creek capacity in the rate base to replace retired Ripley capacity. The condition was that petitioner demonstrate that the need for Wolf Creek capacity had grown by 41 MW between 1986 and 1988, as a result of either additional demand or reduced overall generating capacity. The Rate Stabilization Order provided that, if that showing could be made, the resulting modification in petitioner's rates would take effect in January 1989. It was later determined that the inclusion of the Wolf Creek capacity in the rate base would produce an additional $14.4 million in revenue. Pet. App. 28a-29a, 134a-135a.

KCC brought the Rate Stabilization Order to this Court's attention and argued that it made the constitutionality of the 1985 orders moot. This Court dismissed petitioner's then-pending appeal on that ground. 481 U.S. 1044 (1987).

c. In December 1988, KCC conducted a hearing on the question whether the need for Wolf Creek capacity had grown by the requisite 41 MW. KCC found

that petitioner "had exceeded the 41 MW capacity increase required" for the $14.4 million rate increase. Pet. App. 104a. However, at the same time, KCC granted a motion by respondent Citizens' Utility Ratepayers Board (CURB) to make the increase "interim, subject to refund" and directed KCC's staff to conduct an audit of petitioner's rates. *Id.* at 105a. KCC explained (*id.* at 105a-106a):

> During the past four years the Commission has attempted to achieve equitable solutions to the problems associated with bringing Wolf Creek on-line. This has necessitated a sharing of the burdens and benefits associated with Wolf Creek between [petitioner] and its ratepayers. The Commission is concerned with the risk-sharing aspect of [petitioner's] rates. In order to determine if the appropriate level of risk-sharing is reflected in rates, especially in light of actions taken by [petitioner] since approval of the Rate Stabilization Plan, the Commission believes an audit of [petitioner's] rates is necessary.[1]

2. KCC's staff completed the audit in July, 1989. The staff concluded that the existing rate structure would produce a revenue deficiency of $18 million. The staff did not recommend a rate increase to cover that deficiency, but it did propose that the $14.4 million interim increase be made permanent. KCC set a hearing to receive evidence on that issue and on the audit in general. At the hearing, petitioner supported the staff's recommendation, although it took

[1] After KCC had entered the order at issue here, the Kansas Court of Appeals reversed the December 1988 order to the extent that it made the $14.4 million rate increase interim and subject to refund. *Kansas Gas Electric Co.* v. *State Corporation Comm'n*, No. 63,400 (June 4, 1990).

issue with the audit's treatment of some particular items. CURB proposed a number of adjustments that would increase petitioner's operating income above the figure produced by the audit, in an attempt to provide a basis for reduced rates to petitioner's retail customers. Pet. App. 29a-30a, 33a-34a.

Some of CURB's proposed adjustments involved imputing revenue to petitioner in connection with sales of electricity at rates below those at which Wolf Creek Power could be produced. One such adjustment involved petitioner's sale of 41.2 MW of capacity to the Oklahoma Municipal Power Authority (OMPA). In May 1986, petitioner entered into an agreement with OMPA to provide this capacity from two of petitioner's gas-fired plants. This gas-fired capacity was much less expensive than equivalent Wolf Creek capacity. The contract was filed with FERC, as required by the Federal Power Act, 16 U.S.C. 824d(c). There was no challenge to the agreement, and it took effect in July 1986. Pet. App. 56a, 163a, 166a-182a.

CURB argued that because petitioner had relied on this sale in demonstrating that the need for Wolf Creek capacity had increased by 41 MW between 1986 and 1988 and had thereby been permitted to include additional Wolf Creek capacity in the rate base, the sale's effect was to substitute high-cost Wolf Creek capacity for low-cost gas-fired capacity in petitioner's rate base. To counteract the effect of that substitution, CURB urged that $13.5 million in revenue (the difference between the cost of 41.2 MW of Wolf Creek capacity and the cost of the gas-fired capacity actually used to satisfy the OMPA contract) should be imputed to petitioner. If adopted, the effect of such an adjustment would be to reduce, by that amount,

the sum that petitioner's retail customers would have to pay to produce total revenue sufficient to cover petitioner's approved costs and return on investment. See Pet. App. 56a.

In an order issued on May 13, 1990, KCC adopted the adjustment proposed by CURB. Pet. App. 56a-58a. KCC acknowledged that its action was unusual, but found an adjustment to be justified by "the novel circumstances in this docket." *Id.* at 58a. It explained (*ibid.*):

> This is not a simple sale of excess power by one utility to another. It is a case of one utility selling its cheapest and lowest cost capacity to another, while including its highest cost capacity in rates paid by its jurisdictional, captive ratepayers. Even more importantly, this sale was used as justification for including that high-cost capacity in rates and the resulting interim rate increase at issue in this docket. [Petitioner] met part of the condition precedent established by this Commission for including the revenue impact of the Ripley retirement with [petitioner's] January 1, 1989, rate increase by increasing its capacity sales by 43 MW between 1986 and 1988. Included in those 43 MW is the 41.2 MW of capacity committed for 15 years to OMPA.

KCC made a comparable adjustment to revenues derived from low-cost sales of "interruptible" power to some of its customers. As with the OMPA transaction, KCC determined that an adjustment was warranted to mitigate the effect of those sales' having been used to justify the inclusion of Wolf Creek capacity in the rate base. See Pet. App. 51a-56a.

On the basis of these and other rulings, KCC ordered petitioner to reduce its rates by a total annual

amount of \$8.677,386. Pet. App. 75a.[2] Petitioner sought reconsideration, arguing, *inter alia*, that KCC's treatment of the OMPA sale violated the Supremacy Clause. KCC denied the petition for reconsideration. Pet. App. 97a-101a.

3. Petitioner sought judicial review of KCC's order. In an unpublished decision, the Kansas Court of Appeals affirmed the adjustments imputing income to petitioner. With respect to the sale to OMPA, the court found that there was "substantial competent evidence" to support KCC's finding that the OMPA sale was used to satisfy the condition to the \$14.4 million rate increase. Pet. App. 11a. The court also held that KCC's decision to impute revenue to petitioner on that basis did not transgress the filed rate doctrine applied in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), and *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, 487 U.S. 354 (1988), or otherwise violate the Supremacy Clause.

The court explained that the filed rate doctrine "ensures that the buyer of the wholesale power is allowed to recover its approved costs from the ratepayer." Pet. App. 18a. In the instant case, the court continued, petitioner "is not the buyer of the wholesale power, but the seller" and "[t]he wholesale

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[2] Chairman Henley dissented. Pet. App. 80a-96a. With respect to the OMPA sale, he maintained that the majority's position contradicted representations made to this Court in KCC's motion to dismiss petitioner's prior appeal (see p. 3, *supra*); that the effect of the decision was to penalize petitioner for sales that prior orders had been designed to encourage; that the transaction fully compensated petitioner and was approved by FERC; and that the sale had not in fact been used to satisfy the condition to the inclusion of additional Wolf Creek capacity in the rate base.

rates paid by OMPA were not affected and OMPA was not prohibited from recovering the FERC-approved rates." *Ibid.* Because "FERC regulates the sale of wholesale power" and "[t]he KCC's actions in imputing revenue at Wolf Creek rates does not affect the FERC-filed rates," the court concluded, "the Supremacy Clause does not prohibit KCC's actions." *Id.* at 19a.

The Kansas Supreme Court denied petitioner's request for further review. Pet. App. 24a.

DISCUSSION

Petitioner argues that the imputation of revenue to the off-system sale of capacity to OMPA infringes upon FERC's exclusive jurisdiction over wholesale sales of electric power in interstate commerce. Notwithstanding the form of KCC's order, we do not agree with petitioner's characterization of the adjustment. As we understand KCC's order, the adjustment was ultimately based on the fact that petitioner had relied upon the OMPA sale to justify the inclusion of Wolf Creek capacity in petitioner's rate base. KCC determined, in essence, that it would be unjust to allow petitioner to take advantage of the sale for that purpose without also making an adjustment to mitigate the effect on petitioner's retail customers. As such, the order was merely one of a series of actions KCC has taken to allocate the costs of Wolf Creek capacity between petitioner's shareholders and Kansas ratepayers. The allocation of those costs is not subject to FERC's exclusive jurisdiction and was thus not off-limits to KCC. The fact that KCC expressed its decision in terms of an adjustment to the revenue realized from an interstate sale of

electric power does not, in our view, require a different conclusion. In any event, since the order at issue grew out of the particulars of KCC's prior orders, the case does not present a question of general importance calling for this Court's review.

1. In the order at issue, KCC emphasized the unusual nature of its adjustment and the particular circumstances on which it was based. KCC noted that although its adjustment to petitioner's revenues might be considered "novel," the adjustment was justified by "the novel circumstances in this docket." Pet App. 58a. Later in the order, KCC reiterated that its action was based upon the off-system sale's effect on the rates paid by petitioner's Kansas customers "under the very unique facts" of the case. *Ibid.*

The most important of those facts, KCC made clear, was the role that the OMPA sale played in the rate increase accompanying the retirement of the Ripley plant and the corresponding substitution of 46 MW of Wolf Creek capacity in petitioner's rate base. The majority of KCC determined that, in making the showing KCC had required as a condition precedent to that increase, petitioner had relied on the off-system sale to OMPA. Although a member of the KCC dissented from that determination, the state court found that it was supported by "substantial competent evidence." Pet. App. 11a. KCC emphasized that this circumstance was the fundamental basis for the adjustment. *Id.* at 58a ("Even more importantly, this sale was used as justification for including that high-cost [Wolf Creek] capacity in rates.").

Understandably, petitioner relies upon the form the adjustment took—an increase in revenue attrib-

uted to an interstate sale—in suggesting that the adjustment interferes with FERC's authority to oversee the rate charged in the OMPA transaction. However, when the order is read as a whole, it seems quite clear that the adjustment's essential function was, in the context of past KCC orders, to modify the allocation of the costs of the Wolf Creek plant between petitioner's shareholders and retail customers. The adjustment did not reflect any judgment regarding the merits of the interstate sale, nor did it embody any disagreement with the interstate rates filed with FERC.

2. FERC's jurisdiction does not extend to the allocation of the costs of excess Wolf Creek capacity between petitioner's retail customers and its shareholders. Under Section 201(b) of the Federal Power Act, 16 U.S.C. 824(b), FERC possesses exclusive jurisdiction over "the transmission of electric energy in interstate commerce and * * * the sale of electric energy at wholesale in interstate commerce." Section 205(c) of the Act, 16 U.S.C. 824d(c), requires public utilities to file "schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services." FERC has authority to determine whether any filed rate or contract is "unjust, unreasonable, unduly discriminatory, or preferential" and to substitute reasonable terms. 16 U.S.C. 824e(a). In a case where a transaction involves an allocation of power, "FERC's exclusive jurisdiction applies not only to rates but also to power allocations that affect wholesale rates." *Mississippi Power*, 487 U.S. at 371.

FERC's exclusive jurisdiction has several corollaries, which together have come to be known as the "filed rate doctrine." No party to an interstate wholesale sale of electric power has a right to a rate different from the one filed or determined by FERC. As this Court held in *Montana-Dakota Utilities Co.* v. *Northwestern Public Serv. Co.*, 341 U.S. 246, 251-252 (1951), "the right to a reasonable rate is the right to the rate which the Commission files or fixes, and * * * except for review of the Commission's orders, the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one." See also *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571 (1981). States must also accept as reasonable, for purposes of setting rates paid by retail purchasers of power, the rates adopted by FERC (by means of its acceptance of filings and adjudications), as well as determinations on which those rates are based. That result is "mandated by the Supremacy Clause." *Mississippi Power*, 487 U.S. at 371; *Nantahala*, 476 U.S. at 963-964.[3]

As long as States do not infringe upon FERC's exclusive jurisdiction, they retain their traditional

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[3] The filed rate doctrine is an application of the settled principle that where Congress has regulated comprehensively, so as to occupy the field encompassed by the statute, attempts by States to regulate in the field are preempted. See *Schneidewind* v. *ANR Pipeline Co.*, 485 U.S. 293, 300 (1988); *Northwest Central Pipeline Corp.* v. *Kansas Corp. Comm'n*, 489 U.S. 493, 509 (1989). Thus, application of the filed rate doctrine is not limited to case-by-case consideration of whether an attempt at state regulation is in conflict with an order of FERC. *Mississippi Power*, 487 U.S. at 374. See generally *FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 215-216 (1964).

authority to regulate the rates paid by retail purchasers of electricity. See generally *Arkansas Elec. Coop. Corp.* v. *Arkansas Public Serv. Comm'n*, 461 U.S. 375, 379-388 (1983). Subject to constitutional limits not put in issue by the petition, therefore, KCC had authority to determine how it would divide the costs of the Wolf Creek plant between petitioner's shareholders and its retail customers. In our view, the substance of the order at issue placed it on the State's side of the "bright line" (*Mississippi Power*, 487 U.S. at 374) between FERC's jurisdiction over petitioner's off-system sale to OMPA and KCC's jurisdiction over the treatment, for purposes of retail rates, of the costs of the Wolf Creek plant.

As noted, the adjustment at issue arose out of an arrangement in which the inclusion of Wolf Creek capacity in the rate base was made contingent on a showing of need for that capacity. The effect of the adjustment was not to undercut FERC's approval of the OMPA transaction. Significantly, the sale to OMPA did not arise out of an allocation of power mandated by FERC, and KCC's adjustment did not reflect a regulatory judgment that the price paid by OMPA for the gas-fired power it purchased was unreasonably low.

The KCC's members were in sharp disagreement over whether that judgment represented an unjust departure from prior orders regarding excess Wolf Creek capacity. See Pet. App. 88a-90a (Henley, Ch., dissenting). The proper resolution of that dispute, however, does not involve application of the filed rate doctrine or the Supremacy Clause. The filed rate doctrine serves ot protect FERC's exclusive jurisdiction over interstate wholesale transactions in electric

power, not to assure the regularity of state ratemaking proceedings.[4]

3. As petitioner notes, the Kansas court of appeals distinguished this case from *Nantahala* and *Mississippi Power* on the ground that petitioner was a seller, rather than a purchaser, of wholesale power. See Pet. App. 18a (*Nantahala* and *Mississippi Power* "simply do not address the effect of state regulation on the seller of the wholesale power that recovers the FERC-filed rate"). Focusing on this aspect of the court's opinion, petitioner suggests that this Court's review is warranted to determine whether and to what extent the filed rate doctrine applies to sellers. Whatever the merits of the state court's treatment of this Court's decisions, the fact remains that the rationale of those decisions does not reach this case. In our view, therefore, review is not warranted to consider the general issue of the filed rate doctrine's applicability to wholesale sellers of power.

As this Court has noted, the paradigm case for application of the filed rate doctrine is one in which a State finds a price paid by a utility for a wholesale

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[4] State authorities operate within broad constitutional constraints in setting rates. See, *e.g.*, *Duquesne Light Co.* v. *Barasch*, 488 U.S. 299, 310-316 (1989); *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944).

Petitioner also suggests that the adjustment at issue was inconsistent with representations made to this Court that resulted in the dismissal of petitioner's prior appeal as moot. See Pet. 8-9. In our view, the representation that the March 11, 1987, Rate Stabilization Order established a permanent "fremework" (Pet. 8) for ratemaking over the life of the Wolf Creek plant did not forclose an adjustment of the type at issue. In any event, petitioner has not, at any stage of this case, renewed the claim before the Court in the prior appeal; that claim was that KCC's treatment of Wolf Creek costs was confiscatory.

purchase of power, although mandated by FERC, to be unreasonable for purposes of state ratemaking. In that situation, the filed rate doctrine "ensures that sellers of wholesale power governed by FERC can recover the costs incurred by their payment of just and reasonable FERC-set rates." *Nantahala*, 476 U.S. at 970; *Mississippi Power*, 487 U.S. at 372.[5] A decision by a State that the FERC-mandated price for wholesale power was unreasonable, for purposes of ratemaking for retail customers, would undercut FERC's exclusive jurisdiction over interstate sales.

It is also true, however, that the filed rate doctrine is not invariably limited to this paradigm situation. In *Nantahala*, the utility involved was, in a sense, both a buyer and seller of power subject to FERC's jurisdiction. Nantahala generated power that it provided to TVA; in exchange, it received an allotment of TVA's low-cost "entitlement" power. Nantahala distributed the entitlement power to its wholesale and retail customers, making up the balance of its needs by purchasing higher-cost power at wholesale. FERC determined the amounts of entitlement power that would be allocated to Nantahala and an affiliate in the course of resolving a dispute over the rates Nantahala charged a wholesale customer. In a separate proceeding, state regulators concluded, in effect, that Nantahala should have received a larger share of the low-cost entitlement power, and, for purposes of

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[5] The Court explained in *Nantahala*, 476 U.S. at 970:

> When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a state may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate * * *. Such a "trapping" of costs is prohibited.

retail ratemaking, they revised Nantahala's costs to reflect their view of the proper allocation. As this Court noted, the case did not present "the typical application of the filed rate doctrine," since Nantahala was not just a purchaser of wholesale power distributed to retail customers. 476 U.S. at 969.

Nevertheless, the Court found, the filed rate doctrine required the State to observe FERC's allocation of entitlement power in fixing Nantahala's retail rates. Because Nantahala was legally bound by that allocation, the conflicting allocation employed by state authorities made it impossible for the utility to recover the full cost of the power it obtained at wholesale and supplied to retail customers. The Court explained (476 U.S. at 971):

> Nantahala must under [the State's] order calculate its retail rates as if it received more entitlement power than it does under FERC's order, and as if it needed to procure less of the more expensive purchased power than under FERC's order. A portion of the costs incurred by Nantahala in procuring its power is therefore "trapped."

The order in question in the instant case has none of the characteristics that triggered the application of the filed rate doctrine in *Nantahala*. Here, FERC does not have responsibility for establishing the extent to which petitioner may recover the costs of Wolf Creek power from petitioner's retail customers. FERC did not allocate petitioner's gas-fired capacity to OMPA, thereby obligating petitioner to sell its low-cost capacity off-system, nor did it allocate Wolf Creek capacity to petitioner. The adjustment does not interfere with petitioner's ability to collect the FERC-set rate from OMPA or OMPA's ability to

pass on that rate to its customers. The only "costs" trapped by the adjustment are those associated with operations other than those involved in the transaction regulated by FERC—including, in particular, those associated with Wolf Creek. But that financial impact is no different than the consequences that would have accompanied an order denying petitioner the right to include those costs in its rate base in the first place. Unlike the state order at issue in *Nantahala*, therefore, KCC's order does not embody a judgment regarding the appropriateness of the FERC-approved transaction, and its effect is not to require petitioner's shareholders to absorb the costs of FERC-mandated transactions.

Even if the state court read this Court's filed rate cases too narrowly, therefore, the fact remains that the principles applied in those cases do not foreclose the adjustment at issue.[6] In our view, this Court's review is not warranted to consider the merits of a

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[6] As petitioner notes, this case does not present the question—which is separate from the filed rate doctrine—of whether the state order violates the Commerce Clause. See Pet. 15-16 n.14 (discussing *New England Power Co.* v. *New Hampshire*, 455 U.S. 331 (1982)). While "the Commerce Clause * * * precludes a state from mandating that its residents be given a preferred right of access, over out-of-state consumers, to natural resources located within its borders or to products derived therefrom," 455 U.S. at 338, that constitutional provision also mandates a particularized assessment of the justification for a challenged action, the magnitude of putative local benefits of the action, and the burden imposed upon interstate commerce. *Arkansas Elec. Coop. Corp.* v. *Arkansas Public Serv. Comm'n*, 461 U.S. at 393-394. Petitioner did not rely on the Commerce Clause below; neither KCC nor the Kansas Court of Appeals addressed that provision; and the question presented in the petition does not refer to the Commerce Clause.

distinction drawn in the opinion below that is unnecessary to a proper disposition of the case. Moreover, the order in question was tied closely to the particular features of past orders addressing the costs of Wolf Creek. For these reasons, we do not believe that the decision upholding it presents a question of general significance calling for this Court's attention.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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